BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF THE DELAWARE DIVISION OF CHESAPEAKE UTILITIES CORPORATION FOR A GENERAL INCREASE IN NATURAL GAS RATES AND CHARGES THROUGHOUT DELAWARE AND FOR APPROVAL OF OTHER TARIFF CHANGES (Filed April 4, 1995)	)))))))	PSC DOCKET NO. 95-73

FINDINGS, OPINION AND ORDER OF THE COMMISSION

ORDER NO. 4104

BEFORE COMMISSIONERS: DR. ROBERT J. McMAHON, Chairman
NANCY M. NORLING, Commissioner
JOSHUA M. TWILLEY, Commissioner
ROBERT W. HARTLEY, Commissioner

APPEARANCES:

For the Applicant, Chesapeake Utilities Corporation, Delaware Division:

WILLIAM A. DENMAN, Esq.
Schmittinger & Rodriguez

For the Office of the Public Advocate:

PATRICIA A. STOWELL, Public Advocate

For the Staff of the Delaware Public Service Commission:

JAMES McC. GEDDES, Esq., Rate Counsel
REGINA A. IORII, Esq., Rate Counsel
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I. BACKGROUND

1. On April 4, 1995, Chesapeake Utilities Corporation ("Chesapeake" or "the Company") filed with the Delaware Public Service Commission ("the Commission") revised tariffs designed to produce for its Delaware Division an annual increase of approximately $2,751,189 (or 14.40% of existing revenues), based on a test period ending September 30, 1995. With its application, Chesapeake filed the written testimony of its rate of return consultant, Robert S. Jackson (Exh. 2);[1] its Rate Analyst, Holly H. Carroll (Exh. 5); its Senior Vice President of Natural Gas Operations, Philip S. Barefoot (Exh. 9); and its Director of Natural Gas Accounting and Rates, Michael P. McMasters (Exh. 15).

2. After reviewing Chesapeake's application, the Commission determined that, pursuant to 26 Del. C. §306(a)(1), the revised tariffs should be suspended pending evidentiary hearings concerning the justness and reasonableness of the proposed rate increase. On April 25, 1995, the Commission issued Order No. 3988, in which it formally suspended the proposed revised tariffs, initiated this proceeding, and designated G. Arthur Padmore as Hearing Examiner to conduct the necessary evidentiary hearings to consider Chesapeake's proposal. Chesapeake published notice of the filing of its application as directed by the Commission's Order. (Exh. 1).

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[1] Exhibits entered into the record at the August 30 & 31, 1995 hearing will be cited as "(Exh. __)", (Exh. __ (Name of Witness) at __)", or "(Exh. __ at __)". References to the transcript of this proceeding will be cited as "(Tr. at __)". References to the transcript of the oral argument and Commission deliberations will be cited as "(11/21/95 Tr. at ___)".

3. On April 26, 1995, pursuant to 29 Del. C. §8829(c), the Public Advocate filed her statutory Notice of Intervention in this docket. No other person intervened in this proceeding.

4. Following informal consultations among the parties and the Commission Staff, a procedural schedule for the conduct of this proceeding was developed, proposed to, and approved by the Hearing Examiner.

5. On June 15, 1995, the Company submitted the supplemental written testimony of Messrs. Barefoot and McMasters (Exh. 10 and 16, respectively)[2] and its consultant John Bush (Exh. 7).

6. Upon due notice (Exh. 1), a public comment session was conducted on the evening of July 19, 1995 in the Commission's Dover office.[3] Representatives of the parties and the Commission Staff were present at the public comment session, but no customer nor member of the public appeared.

7. On July 26, 1995, the OPA filed the written testimony of its Principal Assistant, Dr. Rajnish Barua (Exh. 20) and its consultant, Andrea C. Crane (Exh. 21). Staff presented the written testimony of its Public Utilities Analysts Susan B. Neidig (Exh. 23) and Vincent O. Ikwuagwu (Exh. 26), and its consultants, Richard W. LeLash (Exh. 22) and Richard Koda (Exh. 27).

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[2] The supplemental written testimony will be cited as "(Exh. __(Name-S) at __)".

[3] The Commission's Public Information Officer also distributed an advance press release concerning the evening public comment session among the local print and broadcast media, and article concerning the evening session appeared in *The New Journal* and *Delaware State News* newspapers well before the July 19th public comment session.

8. On August 10, 1995, Chesapeake filed the written rebuttal testimony of Ms. Carroll (Exh. 6)[4] and Messrs. Jackson (Exh. 3), Bush (Exh. 8), Barefoot (Exh. 12), and McMasters (Exh. 17). In its rebuttal testimony, the Company revised its requested rate increase to $2,390,582, based on updated data. (Exh. 17 (McMasters-R) at 2).

9. Duly publicized technical evidentiary hearings were conducted on August 30 and 31, 1995 at the Commission's Dover office. Several members of the public, mostly retirees, appeared at the August 30, 1995 hearing.[5] At the August 30, 1995 hearing, the Company sought, and was granted, leave to participate in informal discussions with the OPA and Staff concerning a possible settlement of the issues in this docket. (Tr. at 75-76).

[4] The rebuttal testimony will be cited as "(Exh. __(Name-R) at __)".

[5] A spokesman for the group, Mr. John Maraist, expressed concern that Chesapeake's proposed rate increase was "a little bit beyond outrageous" and questioned whether the Company's proposed 14% rate increase was warranted, in light of his perception that "times are tough for everybody." (Tr. at 9-10).

10. At the August 31, 1995 hearing, the parties and the Staff presented a Stipulation and Agreement ("Stipulation") which proposed to settle all issues in this docket except for the issue concerning the appropriate ratemaking treatment for environmental remediation costs associated with the Dover Gas Light site. (Tr. at 77-78, Exh. 19). With the exception of Mr. Bush,[6] all of the Company witnesses were cross-examined. OPA witnesses Barua and Crane, as well as Staff witnesses Neidig and LeLash, presented live testimony in support of the proposed settlement. In addition, OPA witness Crane and Staff witness LeLash were cross-examined on the remediation cost issue.

11. At the conclusion of the evidentiary hearings, the record consisted of 27 exhibits and a 278-page *verbatim* transcript of the hearings. The parties filed initial and answering briefs addressing the remaining disputed matter.[7]

12. On November 1, 1995, the Hearing Examiner issued his proposed Findings and Recommendations (hereafter cited at "HER at __"). The parties filed exceptions to the HER on November 8, 1995. The Hearing Examiner sought to clarify some concerns expressed in the exceptions filed by Staff and the OPA, and on November 9, 1995 issued a letter addressing those

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[6] Although Mr. Bush did not appear at the hearings, his testimony, which was verified by an attached affidavit, was entered into the record without objection as Exhibits 7 and 8. (*See discussion*, Tr. at 82-84).

[7] The initial and reply briefs shall be cited, as follows:

·In the case of Chesapeake, "(CUC at __)" and "(CUC-R at __)";

·In the case of the OPA, "(OPA at __)' and "(OPA-R at __)"; and

·In the case of the Commission Staff, "(Staff at __)" and "(Staff-R at __)".

issues. The parties responded to the Hearing Examiner's clarification on November 9, 1995 (OPA) and November 16, 1995 (Staff and the Company).

13. On November 21, 1995, the Commission heard oral argument from the parties and deliberated on the issues presented for its consideration. This is the Commission's final Findings, Opinion and Order reflecting those deliberations.[8]

II. THE STIPULATION

14. As previously noted, at the August 31, 1995 hearing, the parties presented a Stipulation which proposed to settle all issues in this docket except the issue concerning the appropriate ratemaking treatment for the remediation costs. In the Stipulation, the parties recommended an increase in base rate revenue of $900,000, which resolved all of the revenue issues in this docket except for the appropriate revenue requirement and ratemaking treatment for environmental remediation expenses. (Exh. 19 at 3, ¶1). Implicit in the stipulated revenue increase is an overall rate of return of 10.12%, which is the product of an 11.50% return on equity on Chesapeake's proposed capital structure of 43.14% long term debt and 56.86% common equity.

15. The Stipulation also proposes that rates designed to recover the proposed revenue increase will become effective for usage on and after December 1, 1995. (DATE TO BE MODIFIED) (Id. at 3, ¶1). In addition, the Settlement encompassed the following revenue requirement issues:

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[8] The rate design phase of this docket has not yet commenced. At the Commission's meeting on November 21, 1995, counsel for the Company indicated that Chesapeake will file its rate design proposal by December 15, 1995. (11/21/95 Tr. at 284).

- In determining its revenue requirement in its next base rate case, Chesapeake will use a weather normalization methodology that relies upon weather data for the most recent consecutive 30-year period. In the Company's next base rate proceeding, however, Staff is free to use some other time period, and the Commission may then determine that some other time period is most appropriate. (Id. at 3-4, ¶ 2a).

- The proposed revenue requirement reflects the inclusion in rate base of $1.2 million relating to costs associated with the installation of Chesapeake's new customer information system, to be amortized over 15 years in the annual amount of $80,000. (Id. at 4, ¶ 2b).

- The proposed revenue requirement reflects the continuation of the amortization of environmental remediation costs approved by the Commission in PSC Docket 93-20 in an annual amount of $107,138. As discussed, *infra*, Chesapeake has not withdrawn its request that the unamortized balance be afforded rate base treatment. (Id. at 4, ¶ 2c).

- The depreciation rates approved by the Commission in Chesapeake's prior base rate proceeding shall remain in effect except that effective December 1, 1995, the Company will implement a depreciation rate of 2.85% for Account No. 311 - Liquified Petroleum Gas Equipment. (Id. at 4, ¶3).

- Chesapeake agrees to affirmatively address the issue of the allocation of overhead costs capitalized in General Plant in its next base rate proceeding. (Id. at 4, ¶4).

16. Chesapeake's initial rate increase request of $2,751,189 included $1,023,000 of revenue requirement associated with environmental remediation expenses. (Id. at 1). In its rebuttal testimony, the Company modified its revenue requirement to $2,390,592, of which approximately $980,000 represented remediation costs.[9] (Exh. 17 (McMasters) at 2; Exh. 18 - Revised Exh. MPM-5). This translated to a $1,410,582 revenue increase, exclusive of environmental expenses. In their

[9] The Company's modified rate request was based on a return on equity of 11.75%.

filed written testimony, the OPA and Staff recommended, respectively, revenue increases of $593,888 and $328,000, based on a return on equity of 11%. (Exh. 19 at 2).

17. The parties acknowledged that the Stipulation represents a compromise of their respective positions regarding the issues in this docket and, thus, "shall not be regarded as a precedent with respect to any rate making or other principle in any future case." (Id. at 4). Moreover, it was explicitly understood that by entering into the Stipulation, no signatory thereto necessarily agreed or disagreed with the treatment of any particular issue other than as specified therein. In addition, the signatories agreed that the resolution of the issues in the Stipulation, taken as a whole, represented a just and reasonable resolution of the revenue requirement issues addressed therein. (Id. at 4-5).

III. THE RATEMAKING TREATMENT OF ENVIRONMENTAL REMEDIATION COSTS

A. BACKGROUND

18. Chesapeake is a previous owner of property known as the Dover Gas Light Site ("the Dover Site").[10] From 1859 to 1949, the Dover Site was used to manufacture gas prior to the existence of the interstate gas pipelines. (Exh. 22 (LeLash) at 49, Schedule 14). The Company, through predecessors, owned the property from 1881 to 1949. (Id. at 52). In addition to the Company, there have been other owners of the Dover Site, including the State of Delaware, which purchased the site from the Company in 1949. (Id. at Schedule 14).[11] Additionally, beginning sometime in the 1950s and ending in 1989, Capitol Cleaners and Launderers, Inc. ("Capitol")

[10] The site is located within the City of Dover, Delaware, on the western half of a city block bounded by New Street, Bank Lane, North Street, and Governors Avenue.

[11] Between 1925 and 1929, Dover Gas became a subsidiary of American Utilities Company. American Utilities Company, including Dover Gas, was purchased by Associated Utilities Investing Corporation, a subsidiary of Associated Gas & Electric Company ("AGECO"). By 1942, Dover Gas had become a subsidiary of General Gas and Electric Corporation ("GENGAS"), which was also a subsidiary of AGECO. Under order to divest Dover Gas by the Securities and Exchange Commission, GENGAS sold Dover Gas to Harrison and Company (an investment banking firm) in 1942. In 1947, Chesapeake Utilities Corporation ("Chesapeake") purchased all of the outstanding shares of common stock of Dover Gas from Harrison and Company. Dover Gas ceased operation of the plant in 1948. (Exh. 11 at 6).

operated a dry cleaning plant on property directly southeast of the Dover Site. Capitol had at least six underground storage tanks, which it used to store fuel oil, heating oil, gasoline, and chlorinated compounds. (Exh. 21 (Crane) at 11). Capitol also operated a facility directly across the street from the Dover Site, at which it had additional underground storage tanks for heating oil, fuel oil, and chlorinated compounds. (Id. at 11-12).

19. In 1980, the United States Congress enacted the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), 42 U.S.C. §§9601 et seq., in an attempt to clean up property and ground water contaminated by the disposal of hazardous waste. CERCLA imposes joint and several liability for cleaning up contaminated sites (commonly known as "Superfund" sites) upon current and past owners or operators of a site from which there has been or there is a substantial threat of a release of a hazardous substance into the environment.

20. The disposal of tars, oils, and other by-products of the gas manufacturing process at the Dover Site has resulted in contamination of the soil and the ground water. The contamination was first discovered in 1984. Soil tests indicated buried building debris, "oily" samples, and fuel-like odors. (Exh. 21 (Crane) at 12). The remains of the coal gasification plant were found buried on the site, and the oily soil samples contained significant contamination levels. (Id.). The ground water on the site and southeast of the site was contaminated with several volatile organic compounds (VOCs), including benzene, toluene, ethyl benzene and xylene, and with polynuclear aromatic hydrocarbons (PAHs) such as naphthalene and acenaphthalene. (Id.).

21. In 1991, the Environmental Protection Agency ("EPA") designated the Dover Site as a Superfund site. Although the plant site itself was only approximately one acre, the entire Superfund site is approximately 23 acres due to the spread of the contamination into the ground

water. The contamination from the gas manufacturing process itself is limited to the plant area near the surface. (Id. at 12-13). Four potentially responsible parties ("PRPs") for the cleanup of the Dover Site have been identified: Chesapeake; General Public Utilities ("GPU"); the State of Delaware; and Capitol. (Exh. 22 (LeLash) at 54).

22. The Company claims that since 1985, it has spent more than $2.7 million on site investigation. (Exh. 21 (Crane) at 14). In July 1990, it entered into an Administrative Consent Order with the EPA and the State of Delaware Department of Natural Resources and Environmental Control ("DNREC"), in which the Company agreed to conduct a remedial investigation and feasibility study ("RI/FS") to determine the nature and extent of the contamination at the site and to screen, develop, and evaluate potential remedial options. The RI/FS was completed in June 1993. Following the RI/FS, the EPA issued a Record of Decision ("ROD") in August 1994. The ROD required:

1. Removal of soil and other contaminant-source material at the Dover Site (consisting of removing, treating, and disposing of the contaminated soil off-site in order to return the site to such a condition that it could be used as a parking lot or for expansion of the Delaware State Museum located on part of the site).

2. Installation of a line of recovery wells in the off-site groundwater plume to prevent continued migration of the contaminants.

3. Installation of other wells within the groundwater plume to extract any concentrations of contaminants.

4. Investigation by Capitol, pursuant to state supervision, of the chlorinated solvents in the groundwater.

5. Installation of wells for monitoring groundwater clean up.

(Id. at 14-15).

23. The total estimated present value cost of these actions is $5.1 million: $3.3 million for soil remediation and $1.8 million for groundwater remediation. (Id. at 15; Exh. 18 at Revised Exh. MPM-5; Exh. 22 (LeLash) at Schedule 13). The costs, however, will not be incurred all at once. According to Mr. Barefoot, the Company's chief policy witness on the remediation issue, expenditures for soil remediation would be made over two years, while expenditures for groundwater remediation could be made over as long as 30 years. (Tr. at 98). Additionally, implicit in the ROD was the assumption that the property would be developed and used in a particular manner. (Tr. at 89-90). The State of Delaware, however, has agreed not to develop the property. (Exh. 21 (Crane) at 25).

24. On May 17, 1995, the EPA issued a Section 106 order requiring the Company and GPU to implement the remedy established in the ROD. (Exh. 10 (Barefoot) at 1). The Company, however, has not yet begun to implement the remediation work specified in the ROD. Instead, it is currently negotiating with the EPA to reduce the level of the soil remediation required, which would lower the estimated cost of compliance from $3.3 million to $1.0 or $1.5 million. (Tr. at 98). Furthermore, the State of Delaware is negotiating with the EPA to resolve its responsibility for the site. If a settlement is reached, any payment by the State would reduce the Company's exposure. (Tr. at 137-138). The same is true with respect to GPU, another PRP with whom the Company is currently negotiating. (Tr. at 138-139)

B. POSITIONS OF THE PARTIES

25. **Chesapeake Utilities**. Chesapeake sought to recover, either through a surcharge or as part of its operating expenses, the present and projected costs associated with the investigation and remediation of certain claims arising out of the operation of the Dover Site and a second

manufactured gas plant site located in Smyrna, Delaware. The Company's environmental expense claim consists of three components: (a) the unamortized balance of remediation costs for which the Commission authorized recovery in PSC Docket No. 93-20; (b) actually-incurred remediation costs since Docket No. 93-20; and (c) the projected EPA ROD soil and groundwater remediation costs.

26. First, with respect to Docket No. 93-20 costs, Chesapeake seeks to revisit the ratemaking treatment that the Commission approved for remediation costs which were at issue in that Docket.[12] In that proceeding, the Commission authorized the Company to amortize $749,971 over seven years. No rate base treatment for the unamortized portion was authorized. In this case, Chesapeake seeks to continue this amortization but also requests the Commission to include the unamortized balance of $491,052 in rate base. (Exh. 15 (McMasters) at 10).

27. Second, with respect to this docket, the Company sought approval to amortize a total of $502,642, representing "actual and forecasted costs through the end of the test period for the

[12] Docket No. 93-20 was a proceeding pursuant to 26 Del. C. §310, which the Commission established to investigate whether the Company was earning more than its authorized rate of return. In order to avoid a formal proceeding to reduce its rates, the Company proposed a voluntary rate reduction contingent on Commission approval of its request to amortize $749,971 of unrecovered remediation expenses over seven years. Staff and the OPA supported the Company's proposal, and it was approved by the Commission in Order No. 3570. It does not appear from the record in that proceeding that Chesapeake raised the issue of including the unamortized balance of the remediation expenses in rate base. (HER at 40).

Dover [ ] and Smyrna sites." (CUC at 17-18). Chesapeake proposed to amortize these costs over five years and to include the unamortized balance in rate base. (Id. at 18).

28. Third, the Company requested a 15-year amortization of an estimated $3.3 million of soil remediation costs and a 30-year amortization of an estimated $1.8 million in capital costs associated with the groundwater remediation. (Id.). Chesapeake also sought to include these unamortized balances in rate base. (Id.).

29. The Company also proposed to credit against the unamortized balance of these expenses any ROD-related amounts which it recovered from third parties. (Id.).

30. The annual revenue requirement associated with the Company's proposed ratemaking treatment of remediation costs is $969,780. (Exh. 18 - Revised Exh. MPM-5). This revenue requirement is in addition to the $107,138 per year already being recovered in the Company's rates as a result of the Commission's decision in Docket No. 93-20.

31. Chesapeake contended that, with few exceptions, most regulatory commissions which have considered the issue have concluded that environmental expenses incurred by gas utilities due to manufactured gas plant operations are recoverable in rates. (CUC at 19). Thus, according to the Company, there was little dispute that these expenses were recoverable. (Id.). What was at issue, however, was the appropriateness of the OPA and Staff proposals that Chesapeake's shareholders "share" these expenses with the Company's ratepayers by denying rate base treatment for the unamortized balance of the remediation expenses.

32. As will be discussed in greater detail infra, Staff proposed that the Commission follow a methodology used in a settlement involving Massachusetts gas utilities, in which the environmental expenses were amortized over a seven-year period without rate base treatment.

Chesapeake contended that Staff had ignored the fact that the Massachusetts settlement permitted the shareholders to retain one-half of insurance and third-party recoveries. (Id. at 20-21, citing Exh. 22 (LeLash) at Appendix "A", pages 8-9). In this instance, however, the Company contended that it had already credited the proceeds it has received from its insurance carriers against remediation expenses "on a dollar-for-dollar basis." (Id. at 21). Thus, if the Massachusetts settlement methodology was adopted in Delaware the Company argued, then 50% of the net insurance proceeds received by the Company, as well as 50% of any funds or benefits obtained by the Company from other PRPs, should be returned to its shareholders to offset the loss of carrying charges. (Id.).

33. Furthermore, the Company contended, under the terms of the Massachusetts settlement, the total annual charge to a utility's ratepayers for environmental expenses during any year could not exceed 5% of the utility's total revenues from firm gas sales during the preceding calendar year; and if the 5% cap resulted in a utility recovering less than the amount that would otherwise be recovered under the agreement, the utility was permitted to recover carrying charges on the uncollected amounts at the utility's net capital cost rate. (Id.). In addition, under the Massachusetts settlement, a utility could opt out of the settlement if its unrecovered environmental expenses exceeded the lesser of $2,000,000 or 5.5% of its 1989 firm gas distribution revenues. (Id.). Chesapeake asserted that under this arrangement it could opt out because its unreimbursed environmental expenses as of July 31, 1995 represented approximately 6.34% of the Company's 1994 firm sales revenues. (CUC at 21-22, citing Exh. 18 -- Revised Schedule MPM-5 at 2).

34. Chesapeake also discussed several cases from other jurisdictions initially cited by Staff witness LeLash which, it claimed, supported its position that recovery of these expenses through rates, without any sharing thereof by shareholders, was appropriate. (Id. at 20-27). In

addition, Chesapeake asserted that at least one Commission had permitted the recovery of forecasted remediation expenses. (Id. at 26-27).

35. The Company acknowledged that the unamortized environmental expenses did not fit neatly into any historical "rate base" item as defined in 26 Del. C. §102. It argued, however, that the Delaware General Assembly recognized the difficulty of listing all components of a utility's rate base because in §102(3)(g), it authorized the Commission to include as a part of a utility's rate base "...any other element of property which, in the judgment of the Commission, is necessary to the effective operation of the utility." Chesapeake contended that denying rate base treatment of the unamortized balance of its remediation expenses would have a major and adverse impact upon the Company's Delaware operations; thus, carrying costs on the unamortized balance of its environmental expenses was "necessary to the effective operation" of the Company. (Id. at 28). In addition, Chesapeake argued, in order to fund its environmental obligations, it would have to obtain capital either in the form of debt or equity, and it was unreasonable to expect either lenders or equity investors to advance funds to the Company to fund its environmental obligations if the Company was not afforded an opportunity to recover in rates the cost of those invested funds. (Id.). Finally, the Company likened the unamortized balance to cash working capital, which is included in rate base. (Id. at 33-34).

36. The Company urged that a sharing of the environmental expenses between ratepayers and shareholders was inappropriate because such a procedure ignored regulatory precedent in Delaware which "requires the Commission to allow the utility the opportunity to recover the full amount of its legitimate operating expenses." (Id. at 28). According to the Company, it is required to operate efficiently, given "the highly competitive marketplace where it offers its services." (Id.).

Chesapeake contended that denying it rate base treatment of the remediation expenses would add to costs and produce no direct increase in throughput; thus, its "competitive position" would be impaired. (Id.).

37. Lastly, with respect to Staff's and OPA's assertions that the Company's shareholders had already been compensated through the return on equity for the risks associated with the environmental expenses, Chesapeake contended that there was no evidence that it had historically been authorized to earn a premium to take into account unknown environmental liabilities. (Id. at 35). Moreover, the Company argued, the Delaware courts had established that the Commission is required to allow a utility to recover, through rates, legitimate operating expenses incurred by the utility during the test period and that the Commission is not authorized to "discount those expenses on some 'equitable' basis as suggested by Staff and OPA." (Id.). In addition, at oral argument, Chesapeake pointed out that as a regulated utility it is not permitted to earn more than its authorized return on equity; consequently, denial of rate base treatment of the unamortized environmental expenses would be unfair. (11/21/95 Tr. at 334).

38. Turning to the Staff's and OPA's contention that the remediation costs were not known and measurable and were therefore too speculative to be recovered through rates, the Company acknowledged that these costs were "estimates." It argued, however, that the costs were "the very same estimates included in the ROD," and since the Company had presented testimony that these estimates were "probably conservative to meet [its] needs," it would be unreasonable to limit recovery in this docket to an amount that was known to be inadequate. (CUC at 36). Chesapeake thus requested the Commission to allow it to recover its estimated costs and, to the extent that there

were overcollections, an appropriate procedure could be implemented to refund any overcollection to the ratepayers. (Id.).

39. **The Office of the Public Advocate**. The OPA took issue with Chesapeake's proposal to include in rate base the unamortized balance of the remediation costs approved for rate recovery in Docket No. 93-20. (Exh. 21 (Crane) at 21). The OPA contended that the Company had demonstrated no reason why the Commission should revisit its decision in that docket, and so recommended continuing the ratemaking treatment that had been previously approved in Docket No. 93-20. (Id.).

40. With respect to the costs incurred by the Company through the rate effective date, the OPA recommended that the Company be permitted some recovery of these costs, but that the responsibility for these costs be shared equally between the ratepayers and the stockholders. (Id. at 21-22). The OPA proffered three reasons for this approach. First, according to the OPA, ratepayers had nothing to do with the events that caused the site to become contaminated and, thus, there was no reason to force them to fund all of the remediation costs. Second, the OPA noted that the Company's stockholders had been compensated for both financial and business risk through the return on equity granted by the Commission, which generally represents a premium over the risk-free return. Consequently, the OPA argued, "[i]t would be illogical and unfair to ignore this premium now that the Company is in fact facing a situation that results in some risk." (Id. at 22). Third, the OPA observed that because the actual contamination of the site occurred before the Company became subject to Commission regulation, asking today's ratepayers to fund the cost of remediation caused by activities that took place prior to regulation violated the regulatory compact between the Company and current ratepayers. (Id.).

41. Thus, the OPA recommended that the Company be permitted to recover half of the net present value of these costs, amortized over ten years, with no rate base treatment of the unamortized balance. (Id. at 23). This recommendation resulted in an annual recovery of $25,695. (Id.).[13] The OPA also recommended that if the Commission selected a different amortization period, the annual amount to be amortized should be adjusted to ensure that the ratepayers would bear only 50% of these costs on a net present value basis. (Id. at 24).

42. Lastly, with respect to the estimated costs of soil and groundwater remediation contained in the EPA ROD for which the Company sought recovery, the OPA contended that none of these costs should be included in base rates at this time. (Id. at 24, 27-28). First, the OPA claimed, the ROD remediation costs were excessive in light of the fact that the State of Delaware, the present owner, had agreed not to develop the property. (Id. at 25). Second, the OPA asserted there were "strong indications" that the actual remediation costs could be far less than those reflected in the ROD.[14] Third, according to the OPA, the Company would not incur these costs during the test period. Because the test period ended in September 1995, the OPA noted that it would be "virtually impossible" for the Company to incur any of these costs during the test period. (Id. at 25-26). Fourth, there were other PRPs who may be responsible for these remediation costs who had not yet accepted responsibility. (Id. at 26-27). Thus, not only was there uncertainty with respect to the ultimate level of required remediation, but there was also uncertainty about the Company's ultimate

[13] OPA witness Crane explained that recovery of $25,695 per year for 10 years resulted in total nominal recovery of $256,950, which, when discounted to present value, had a net present value of $159,957 (half of $319,911). (Exh. 21 (Crane) at 23-24, Schedule 24).

[14] The OPA observed that the Company had submitted alternative proposals to the EPA that would significantly reduce remediation costs, and the Company and the State of Delaware were negotiating with the EPA to reduce the level of remediation established in the ROD. (Id. at 25).

share of the cost responsibility. In addition, insurance proceeds and/or recovery of damages from the State of Delaware and Capitol could further reduce the Company's remediation expenditures. (Id. at 27).

43. With respect to the Company's claimed expenses for the Smyrna site, the OPA contended that not only had Chesapeake failed to provide any record support for these costs, but it had also failed to provide a description of the Smyrna site and the history that gave rise to the current need for remediation. (OPA-R at 4). The OPA, therefore, recommended that recovery of costs associated with the Smyrna site be disallowed for lack of evidentiary support in the record. (Id.).

44. **Staff.** Staff also contested Chesapeake's proposed ratemaking treatment for remediation costs. According to Staff witness LeLash, because of the "extreme variability of expenditures and reimbursements," the Company's requested amortization should be limited to actual net expenses to avoid excessive under- or over-recoveries. (Exh. 22 (LeLash) at 52). Arguing that the Company's remediation expense estimate represented the "worst case scenario," Mr. LeLash contended that the Company had failed to consider several factors which would mitigate a substantial portion of its claim. (Id. at 51).

45. First, he pointed out, the State of Delaware appeared to be close to settling the EPA's claim against it, which would reduce the amount of remediation costs that the Company would have to pay. Second, a modification to the ROD could reduce the soil remediation costs by more than $2 million. Third, the Company did not include any allowance for outstanding claims against other PRPs, despite substantial expenditures incurred in pursuing such claims. Lastly, even if the ROD was not modified, the expenditures necessary to meet its requirements would extend over a longer

time period than that assumed by the Company. (Id. at 52-52). By omitting these factors, Mr. Lelash contended, Chesapeake was overstating its estimated remediation expenses and was asking ratepayers to pay an amortization that was likely to exceed the Company's net out-of-pocket expenditures. (Id. at 52). In addition, he observed, the Company's estimated amortization could increase ratepayer charges by more than 5% -- an annual limit deemed by many local distribution companies as reasonable for recovering remediation costs. (Id.). Staff witness LeLash also testified that he was not aware of any commission that currently allowed recovery of forecasted remediation expenses. (Id.).

46. In addition, Staff noted that other PRPs had been identified as having responsibility for the contamination at the Dover Site. (Id. at 54). Furthermore, Mr. LeLash noted that there was a potential for insurance reimbursement of remediation costs and that the Company had already received some reimbursement from its insurers. (Id. at 54-55). According to Mr. LeLash, the Company should be investigating ways to reduce the costs of remediation, such as awarding remediation work to independent contractors on a least-cost basis; seeking reimbursement of remediation expenses from insurers; investigating new interpretations being applied to comprehensive general liability policies in order to determine whether there were any additional grounds for pursuing claims against its insurers; exploring opportunities to modify remediation requirements; seeking to simplify the investigation and survey requirements (as was done by a gas company in New Jersey); and reducing remediation costs based on the source of capital employed to fund those costs. (Id. at 55-57).

47. With respect to the issue of who should bear the costs of remediation, Staff contended that it was relevant to consider the reasonableness of past actions and that since there was no

indication in the record developed in this case that the Company's predecessors' operations at the site were reasonable, no conclusion should be drawn as to (a) the reasonableness of those activities or (b) whether such activities conformed to then existing industry standards. (Id. at 59; Staff-R at 8-9). Staff, nonetheless, acknowledged that because of the general lack of records covering the period when gas was manufactured at the Dover Site, it was nearly impossible to assess the reasonableness of actions during that time.

48. Because of the difficulty in reaching conclusions concerning the reasonableness of past actions, Mr. LeLash noted that several regulatory commissions had adopted an approach that allocated the remediation costs between the stockholders and the ratepayers without making a specific factual finding as to reasonableness. (Exh. 22 (LeLash) at 58). Staff recommended, therefore, that the Commission consider such "sharing"[15] as an alternative to attempting to assess the reasonableness of the Company's actions during historic periods.[16] (Id. at 59-62).

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[15] As Mr. LeLash testified during the evidentiary hearing, "sharing" was somewhat of a misnomer, since under Staff's proposal the ratepayers would in fact be paying 100% of the actually-incurred, reasonable remediation expenses; however, the ratepayers would be given time over which to pay these expenses, and the shareholders would bear the carrying costs associated with paying these expenditures over the amortization period. (Tr. at 223-225).

[16] Staff identified other state commissions that had approved some sort of sharing of the costs of manufactured gas plant remediation as well as the following potential issues for the Commission:

(1) whether, if certain Company actions increased the level of expenses that will ultimately be incurred, the increased costs should be excluded from the net recoveries at issue in this case; and (2) prospective remediation actions that currently cannot be evaluated for reasonableness (e.g., cost containment actions and indemnification from PRPs). (Exh. 22 (LeLash) at 59-62).

49. In determining the proper allocation of remediation costs between shareholders and ratepayers, Staff contended that the Commission should consider issues of equity, incentive and regulatory precedent. (Id. at 59). With respect to regulatory precedent, Staff pointed to this Commission's previously approved ratemaking treatment of remediation costs for the Company that resulted in a sharing between ratepayers and stockholders through the amortization of costs over a certain number of years and the exclusion of the unamortized balance from rate base. (Id. at 62). Staff also observed that in making a determination concerning the recovery of remediation costs, other commissions had given weight to whether or not the site at issue was being used to provide utility service and whether or not (as in this case) the site was owned by a third party, in which case remediation would provide no direct benefit to utility ratepayers. (Id. at 63). Staff noted that in the non-regulated sector, remediation costs are generally not considered to be associated with current operations; instead, they are charged to retained earnings, which properly matches the expense with the underlying historical activity. (Id.).

50 With respect to incentives, Staff contended that the best and most logical incentive in this instance would be to place Chesapeake at risk for a portion of these costs. (Id.). According to Mr. LeLash, insurance reimbursement and assignment of liability to other PRPs were areas of cost containment that were within the Company's control, and by placing some of the risk on the Company the Commission could ensure that Chesapeake would take appropriate action. (Id.). Moreover, Mr. LeLash asserted that stockholders had been compensated in their cost of equity for risks associated with the Company's operations; thus, it would be "illogical" to suggest that stockholders should not bear any of the risks associated with remediation costs. Had the Company's stockholders been granted risk-free returns, then, Mr. LeLash noted, there might be an argument that

they should not bear any of the remediation costs. However, the Company's returns on equity have been such that its stockholders have earned a premium for assuming certain risks such as those associated with remediation. Furthermore, Mr. LeLash observed, to the extent the Company and its predecessor did not follow procedures available to reduce the level of residual contamination from the manufacturing process, it was the stockholders who benefitted therefrom. (Id. at 65-65).

51 Staff suggested that the Commission generally follow the procedure used in a settlement in Massachusetts to allocate the costs between stockholders and ratepayers on a 50-50 basis. Under the Staff proposal: (a) the actual expenses incurred by the Company would be amortized over seven years, with no rate base treatment for the unamortized balance; (b) the expenses incurred in each year will be placed in a pool for that year; (c) the annual amounts recoverable from each pool will be added together to reach the total annual amount to be recovered on an ongoing basis from the ratepayers through a remediation rider; and (d) the remediation rider will be implemented as part of base rates and will be subject to change on an annual basis. (Tr. at 226). Staff explained that the use of a rider would have the following benefits: (a) it would reduce the need for regulatory proceedings associated with major expenses or reimbursements; (b) it would allow recovery of actual expenses only, subject to Commission review of their reasonableness prior to authorizing recovery; and (c) if timed to coincide with the Company's fuel clause filing, would obviate the need for additional regulatory proceedings. (Exh. 22 (LeLash) at 69).

52 Staff further proposed that the remediation expense amortization be allocated to all throughput. (Id. at 70).

53 At the August 31, 1995 evidentiary hearing, Mr. LeLash acknowledged the Company's concern that Staff's amortization proposal could result in the creation of a large

regulatory asset (i.e., the unamortized balance). He testified that if the Commission became convinced that the amount of such a regulatory asset was impairing the Company's financial stability, it could establish a cap on the amount of the unamortized balance and allow the Company to earn the equivalent short-term interest rate on any amount in excess of the cap. (Tr. at 230-231). However, Mr. LeLash emphasized that Staff was not recommending that any cap be established at this time because it did not believe that the unamortized expenses to date were significant enough to warrant such a provision. (Id. at 258-259, 266-267, 269).

54 Finally, Staff contended that Chesapeake had failed to meet its burden of proving that the Smyrna site costs were appropriate for recovery because there was nothing in this record from which it could be determined whether the property was used and useful in the provision of utility service, whether there was any potential for insurance reimbursement, whether there were any other potentially responsible parties, the remediation efforts undertaken, whether the Company still owned the site, or even where the site was located. (Staff at 32; Staff-R at 15).

IV. THE HEARING EXAMINER'S FINDINGS AND RECOMMENDATIONS

A. THE STIPULATION

55 The Hearing Examiner first addressed the Stipulation, which resolved all of the issues except for the recovery of the Company's remediation costs. He began by identifying the pertinent ratemaking principle under Delaware law: that ultimately, the rates approved by the Commission must be just and reasonable. 26 Del. C. §303(a). He observed that while rates should be fair to both the utility and the consuming public, citing In the Matter of Wilmington Suburban Water Corp., 367 A.2d 1338, 1343 (Del. Super. 1976), rates are just and reasonable if they are "`sufficient to yield a fair return to the utility upon the present value of property dedicated to public use.'" (HER at 7-8,

quoting Public Service Commission v. Wilmington Suburban Water Corp., 467 A.2d 446, 447 (Del. 1983)). Thus, in determining whether the Stipulation should be approved, the Hearing Examiner focused on whether the evidentiary record supported a finding that the revenue requirement produced by the Stipulation would result in just and reasonable rates. (HER at 7).

56 The Hearing Examiner concluded that the Stipulation would produce just and reasonable rates, and recommended that the Commission approve it. (Id. at 8). First, he noted, both the Staff and the OPA (who is statutorily obligated to advocate the lowest reasonable rates consistent with the maintenance of adequate utility service and an equitable distribution of rates among all customer classes) supported the Stipulation. (Id.). Staff witness Neidig testified that the Stipulation was in the public interest because it was a fair and equitable resolution of the revenue requirement issues. (Id., citing Tr. at 277). She further testified that after considering additional closings to plant in service during the test period, other pro forma adjustments, and Staff's recommended return on equity, Staff's revised revenue requirement increase approached the $900,000 increase to which the parties had agreed in the Stipulation. (HER at 8, citing Tr. at 277). Moreover the Stipulation avoided additional costly litigation of these issues. (HER at 8, citing Tr. at 277). The Hearing Examiner also relied on OPA witness Crane's testimony in support of the Stipulation in concluding that it should be approved. (HER at 8-9, citing Tr. at 205-06).

57 Second, the Hearing Examiner found that approving the Stipulation was consistent with the legislative mandate of 26 Del. C. §512. That statute instructs the Commission to encourage the resolution of matters brought before it by stipulations and settlements; permits the Commission Staff to participate actively in the resolution of such matters; and allows the Commission to approve

stipulations or settlements if such approval is in the public interest even if all parties have not agreed to or approved the stipulation or settlement. (HER at 9).

58 Third, the Hearing Examiner observed that the Commission's approval of the Stipulation provided no precedent for resolution of the settled issues in future base rate cases. (Id., citing Re Minnegasco, Inc., 143 PUR 4th 416, 424 (Minn. PUC 1993). Hence, the Commission remained free to decide these issues differently in a future proceeding. (HER at 9).

B. RECOVERY OF THE COMPANY'S REMEDIATION COSTS

1. The Smyrna Site Costs

59 The Hearing Examiner agreed with Staff and the OPA that there was insufficient record evidence upon which the Commission could make an informed decision concerning the recovery of these costs. (HER at 27). Consequently, the Hearing Examiner recommended that the Commission deny recovery of these costs in rates. (Id.).

2. The Dover Site Costs

60 The Hearing Examiner found that, given the lack of records pertaining to the operation of the manufactured gas plant at the Dover Site, it was impossible to determine the reasonableness of the past actions of the Company's predecessor. (Id.). Even if such records were available, however, in the absence of specific evidence of behavior of the Company or its predecessors that was inconsistent with then-existing standards, the Hearing Examiner believed that it would be inappropriate to penalize the Company "for lacking the prescience to conform to today's rigorous environmental standards." (HER at 28). Additionally, the Hearing Examiner observed, there may have been numerous entities other than the Company who may have contributed to polluting the site. Finally, the Hearing Examiner noted that no party was supporting an outright

denial of recovery of all remediation costs. (Id.). Consequently, the issues requiring resolution were: (1) the amount of expenses to be recovered; (2) the appropriate ratemaking treatment of those costs; and (3) the appropriate mechanism through which to effect their recovery. (Id.).

a. The Estimated Recovery Costs

61 The Hearing Examiner recommended that the Commission reject Chesapeake's request to recover in current rates the $5.1 million of estimated remediation expenses. (Id. at 29). First, the Hearing Examiner relied upon the Commission's decision in PSC Docket No. 85-17,[17] in which the Commission denied Chesapeake's request to amortize $1.5 million of estimated remediation costs for the Dover Site because of "`the uncertainty surrounding the nature and extent of any future expenditures on this matter.'" (Order No. 2728, p. 6, ¶12). In this docket, the Hearing Examiner observed, although the magnitude of estimated remediation costs appeared to have increased substantially, the amount that the Company will actually spend remained uncertain. The Hearing Examiner cited the Company's witnesses who acknowledged that these costs were estimates, and the Company's concession in its brief that the only certainty was that "`Chesapeake will spend substantial sums of money in the near future.'" (HER at 29, quoting CUC-R at 4)(emphasis in original).

62 Furthermore, the Hearing Examiner found no evidence in the record supporting a contention that the $5.1 million was representative of the prospective expense the Company would

[17] In the Matter of the Application of Chesapeake Utilities Corporation for a General Increase in Gas Rates Throughout Delaware and for Approval of Other Changes to Its Tariff, PSC Docket No. 85-17, Order No. 2728 (Del. PSC, March 25, 1986)(hereafter "Order No. 2728").

incur to clean up the Dover Site. Rather, the record suggested that the Company's ultimate liability for remediation expenses could well be less than the estimates. First, the State of Delaware (the current owner of the property), who was identified as a PRP, had reached a tentative settlement with the EPA, which would reduce the Company's estimated liability. Second, the State had agreed not to build on the site, and it and the Company were currently engaged in joint negotiations with the EPA to reopen the ROD to reduce the level of soil remediation required therein. If this effort was successful, the Company's liability would be decreased further. Third, the Company recently filed with the EPA a feasibility study in which the alternative proposals for soil remediation were $1.14 million and $1.55 million -- far less than the $3.3 million estimate contained in the ROD. Thus, these unknown factors could substantially reduce the amount of remediation expense that the Company would ultimately incur. (HER at 30).

63 The Hearing Examiner also found that under traditional ratemaking principles, the estimated remediation costs were not sufficiently known and measurable to be included in the ratemaking calculus. He observed that Delaware, like most other states, follows the test year/test period ratemaking process, pursuant to which a utility's revenue requirement equals the total of its operating expenses, depreciation, taxes, and a reasonable rate of return on its rate base. (Id.). Utilities, however, had been permitted to adjust their test period rate base and/or operating expenses to include post-test period costs when those costs were known and reasonably ascertainable; the rationale for allowing such adjustment is that ratemaking is prospective in nature and the purpose of a test period is to provide a representative level of expenses for recovery on a going-forward basis. (Id. at 31). Consequently, the Hearing Examiner noted, it was "essential" for the costs to be included in rates to be recurring and capable of being determined without speculation. (Id.).

64 The Hearing Examiner rejected the Company's argument that its estimated remediation costs were legitimate expenses that it was entitled to recover through rates. The Hearing Examiner explained that this contention was contrary to "well-established case law," and observed that cost recovery has been denied even in the absence of a finding of management imprudence. (Id. at 31-32, quoting Re Southern California Gas Co., 109 PUR 4th l, 31 (Cal. PUC 1990). The Hearing Examiner acknowledged, however, that there occasionally were "exceptional instances in which an abnormal expense arises," in which commissions had departed from the normal regulatory process to permit a form of rate recovery that is just and reasonable under the circumstances for both the utility and its ratepayers. (HER at 32). In his view, the Commission recognized such an exceptional case in Docket No. 85-17, where it made a "significant and clear distinction" between the appropriate rate recovery of operating expenses (which are typically recurring expenses necessary to the utility's day to day operations) and the recovery of other types of expenses that generally represent unique or extraordinary non-recurring costs. (Id. at 32-33).

65 The Hearing Examiner concluded that the Company's estimated remediation expenses were not operating expenses, but rather were "extraordinary" expenses that would qualify for special treatment. (Id. at 33). First, he found, although the expenses were currently unascertainable, they could become significant over time, especially when compared to the Company's revenue requirement. Second, the costs were non-recurring, and thus should not be reflected in rates established for prospective application. Third, although the reasonableness of the past actions at the site that resulted in the expenses was impossible to determine, it was clear that the Company would be responsible for a significant portion of the remediation costs. (Id.).

66 The Hearing Examiner recommended that the Commission adopt Staff's position, which would allow the Company to amortize its annual actual net remediation expenses over seven years with no rate base treatment of the unamortized balance. (Id. at 34). Under this procedure, the expenses incurred each year would be placed in a pool for that year, and then the annual amounts recoverable from each pool would be added together to reach the total annual amount to be recovered from ratepayers. (Id.).

b. The Method Of Recovery

67 The Hearing Examiner also recommended that the Commission approve the use of a rider or surcharge to base rates to recover the annual net remediation costs. (Id. at 34-35). The Hearing Examiner found that using a rider to collect the remediation costs would have several benefits. First, it would reduce the need for regulatory proceedings associated with major expenses or reimbursements. Second, it would allow recovery of only the Company's actual remediation expenses (subject to a reasonableness review prior to authorizing recovery). Last, the review could be timed to coincide with the Company's annual fuel clause proceeding, which would avoid additional regulatory proceedings. (Id. at 34).

68 The Hearing Examiner rejected Staff's proposal to allocate the remediation costs on the basis of throughput, however. (Id. at 35). According to the Hearing Examiner, an allocation on the basis of throughput would adversely impact the rates of large customers, who could be encouraged to switch to more competitive fuels. Hence, the Hearing Examiner concluded, the costs of the remediation rider should be assigned so as to avoid an undue impact on any particular customer class. He suggested that the remediation costs be spread among all service classifications

so that each customer in each class would pay an equal share of the remediation expenses to be amortized. (Id.).

c. The Amount Of Remediation Expenses To Be Amortized

69 The Hearing Examiner concluded that there was insufficient record evidence from which to determine the amount of remediation expenses to be amortized. (Id. at 36). As previously discussed, the Hearing Examiner rejected Chesapeake's proposal to recover its estimated remediation costs, since there was convincing testimony from Staff and the OPA that those expenses could be greatly reduced by contributions from other PRPs and by modification of the ROD. (Id.). Thus, the Hearing Examiner recommended that the Commission find that the record provided insufficient information to determine the actual amount of remediation expenses for which the Company would be responsible. (Id. at 37).

d. The Propriety Of Including The Unamortized Balance Of Remediation Expenses In Rate Base

70 The Hearing Examiner recommended that the Commission deny Chesapeake's request to include the unamortized balance of remediation expenses in rate base. (Id.). First, he noted that under Delaware law, a utility may earn a return only on investments that are used and useful in providing utility service. 26 Del. C. §102(3)a. Indeed, the Hearing Examiner stated, regulated utilities have traditionally been permitted to earn a return only on plant that is used and useful in the provision of utility service so as to ensure that ratepayers are not paying for things that provide no benefit to them. (Id. at 37-38, citing Re Williston Basin Interstate Pipeline Co., 105 PUR 4th 374, 385 (F.E.R.C. 1989)). Here, the record was clear that the Dover Site was not now, nor would it ever be, used and useful in providing utility service to Chesapeake's ratepayers. (Id. at 38).

71 The Hearing Examiner rejected the Company's argument that the unamortized balance of the remediation costs should be given rate base treatment under the catch-all provision of 26 Del. C. §102(3)g as an "element of property... necessary to the effective operation of the utility." (Id.). He cited the Commission's decision in PSC Docket No. 91-20,[18] in which the Commission acknowledged that §102(3)g gave it the discretion to determine whether a particular item not meeting the other criteria of §102(3) should be included in rate base, and concluded that because the item at issue there no longer was used and useful in providing utility service to the utility's ratepayers, it should not be included in rate base. (Id. at 38-39). According to the Hearing Examiner, the same rationale was applicable to the unamortized balance of remediation expenses at issue here. (Id. at 39).

72 The Hearing Examiner also rejected the Company's contention that it was unreasonable to expect its stockholders to bear any portion of the remediation costs. The Hearing Examiner observed that utility stockholders, including Chesapeake's, were routinely compensated for unforeseen risks such as the remediation costs through the return on equity; hence, it was reasonable for the stockholders to assume some of the burden of this extraordinary expense by foregoing carrying costs on the unamortized balance. Moreover, the Hearing Examiner noted, the Company would not suffer any actual book loss from being denied carrying costs on the

[18] In the Matter of the Application of Delmarva Power & Light Company for an Increase in Its Electric Base Rates and for Certain Revisions to Its Electric Service Rules and Regulations, PSC Docket No. 91-20, Order No. 3389 (Del. PSC, March 31, 1992).

unamortized balance and would not sustain any charge to operating income as long as it recovered its remediation expenses in rates. (Id.).

73 The Hearing Examiner further dismissed Chesapeake's contention that the unamortized balance of remediation costs should be afforded rate base treatment because it was comparable to a cash working capital allowance, which is traditionally included in rate base. (Id. at 41). According to the Hearing Examiner, the Company had misconstrued the rationale for including working capital in rate base. The inclusion of working capital in rate base reflects a recognition of a lag in the recoupment of costs of assets that are used and useful in providing utility service. "Regardless of the nature of the working capital asset, it must be used and useful to the [utility's] customers.'" (Id. at 41-42) (quoting Re Williston Basin Pipeline Co., 111 PUR 4th 484, 487 (F.E.R.C. 1993). Hence, the Hearing Examiner was not persuaded that the unamortized balance of remediation expenses should be given the same ratemaking treatment as cash working capital. (HER at 42).

74 Finally, the Hearing Examiner rejected the authorities from other jurisdictions cited by the Company in support of allowing rate base treatment for the unamortized balance of remediation costs. (Id. at 42). The Hearing Examiner reviewed those authorities and found them distinguishable from the present situation, either because the utility still owned all or most of the sites in question, or the sites were found to be used and useful in providing utility service, or the treatment was granted only for the specific case under consideration because of certain distinguishing factors. (Id. at 42-43).

e. Inclusion Of Unamortized "Docket No. 93-20" Remediation Costs In Rate Base

75 The Hearing Examiner rejected the Company's request to include in rate base the unamortized balance of the remediation costs previously approved for recovery by the Commission in Docket No. 93-20. (Id. at 40). In addition to the reasons he had previously explained for denying rate base treatment, the Hearing Examiner also found that permitting rate base treatment of these particular costs would violate the regulatory prohibition against retroactive ratemaking in that it would allow the Company to recover costs associated with past expenses. Public Service Commission v. Diamond State Telephone Co., 468 A.2d 1285, 1298 (Del. 1983).

f. Effect Of The Unamortized Balance On The Company's Financial Stability

76 The Hearing Examiner, however, recognized that his recommended ratemaking treatment would create a regulatory asset that at some point could become so large as to impair the Company's financial stability. He therefore recommended that if, during the annual review of its remediation expenses, Chesapeake convinced the Commission that the size of the unamortized balance was damaging it financially, the Commission could establish a cap on the magnitude of unamortized expenses and allow the Company to earn the equivalent short-term interest rate on any amount exceeding that cap. (HER at 37).

IV. THE PARTIES' EXCEPTIONS

A. STAFF AND THE OPA

77 Staff and the OPA concurred with substantially all of the Hearing Examiner's findings and recommendations. (Letter dated November 8, 1995 from Regina A. Iorii, Esq., Rate Counsel; OPA Exceptions to the Findings and Recommendations of the Hearing Examiner dated November 8, 1995). Both Staff and the OPA excepted to the Hearing Examiner's recommended allocation of the remediation rider on a customer class basis, arguing that this allocation would adversely impact the smaller customer classes. (Staff at 1-2; OPA Exceptions at 4-5). Staff suggested that the Commission instruct the parties to investigate alternative methods of allocating the costs of the rider, and to report back to the Commission so that it would have an informed basis on which to determine the appropriate allocation of these costs. (Staff at 2).

78 The OPA argued that allocating the remediation costs on the basis of throughput was the most equitable allocation method at this time, and urged the Commission to approve that method. Alternatively, however, the OPA suggested that this aspect of the case be deferred to allow the parties to review the Company's test period costs and to develop implementation plans for presentation to the Commission. In any event, the OPA requested the Commission "to carefully review the impact of any proposed allocation on residential and small commercial customers." (OPA Exceptions at 4-5).

79 Staff further observed that while the Hearing Examiner appeared to be recommending Staff's proposed procedure for determining the annual amount of remediation expenses to be amortized, it was unclear whether he had embraced Staff's proposal in its entirety. (Staff at 1). Staff therefore requested the Commission to clarify that the Massachusetts formula that served as the basis

for Staff's proposal was to be used to determine the annual amortization amount, and that its provisions for allocation of reimbursements and opting out did not apply. (Id.).

80 Similarly, the OPA observed that the Hearing Examiner did not discuss the effect of deferred taxes on his recommendation. The OPA requested clarification that the Hearing Examiner intended to recommend a 50/50 sharing of the remediation costs between stockholders and ratepayers. The OPA pointed out that, read literally, the recommended seven-year amortization with no rate base treatment of the unamortized balance and no adjustment for the effect of deferred taxes resulted in a 70% ratepayer/30% stockholder split. (OPA Exceptions at 2). The OPA repeated its reasons for advocating that the remediation costs be shared equally between the stockholder and the ratepayers, and argued that such an allocation was the only fair result. (Id. at 3-4).

B. THE COMPANY

81 The Company excepted to nearly all of the Hearing Examiner's recommendations. First, it excepted to the Hearing Examiner's recommendation to deny rate base treatment to the unamortized balance of its remediation costs. (CUC Exceptions at 4). It cited the same authorities in support of its position, and contended that the Hearing Examiner had made no effort to explain what distinguished those cases from Chesapeake's. (Id.). The Company pointed out that in several of the cases, the utility no longer owned the site in question, but rate base treatment of the unamortized balance of remediation costs was nonetheless permitted. (Id. at 5).

82 The Company further argued that it was appropriate to include the unamortized balance of its remediation costs in rate base because the payment of the costs enabled Chesapeake to comply with its legal obligations and remain in business; hence, the payment of these expenses was "used and useful" (Id.). In addition, the expenses had a "clear nexus" to the site because the site was

used to supply gas service to the Company's corporate predecessor's customers. Moreover, the Hearing Examiner's "narrow" definition of "used and useful" implied that full recovery would be permitted if the Company was still using the site as a parking lot or in some other capacity, which, according to the Company, was "illogical." (Id. at 5-6).

83 The Company took issue with the Hearing Examiner's rejection of its argument that the unamortized balance could be included in rate base pursuant to 26 Del. C. §102(3)g, claiming that by requiring the item to be included to be "used and useful" the Hearing Examiner had effectively written Section 102(3)g out of the law. (Id. at 6). The Company contended that carrying costs were necessary to its effective operation because of the significant financial impact of the longer amortization period and the greater magnitude of the costs involved. (Id. at 7). Indeed, the Company asserted, based upon existing projections, an unseasonably warm year could result in reducing the Company's interest coverage ratio to a level below the minimum required by its debt instruments. (Id.).

84 The Company further argued that the carrying costs associated with its environmental expenditures were part of the actual economic cost it incurred in complying with environmental laws and regulations, and that denying such costs was effectively denying it an opportunity to recover its legitimate costs of doing business. (Id. at 8).

85 The Company also took issue with what it called the Hearing Examiner's use of a "financial stability standard" to determine whether the Company should be permitted to recover carrying costs on the unamortized balance of the remediation costs. (Id. at 9). According to the Company, the Hearing Examiner implicitly concluded that the current cost levels did not reach the undefined level of impairing the Company's financial stability. (Id. at 10). The Company argued,

however, that under the Massachusetts settlement procedure that served as the basis for Staff's proposal, it would have been able to opt out of that settlement because it had exceeded the maximum level of unamortized expenses. Moreover, the Company claimed, it would clearly incur substantial costs in the near future. Thus, it argued, "[t]he only way to avoid what would otherwise be an unnecessary regulatory proceeding is to grant the rate base treatment or carrying cost recovery now." (Id.).

86 The Company also disputed the Hearing Examiner's recommendation to allocate the costs of the remediation rider equally among all service classifications. (Id. at 10-11). The Company argued that it had already maximized the amount that it could charge its flexible rate customers without their switching to an alternate fuel, and that categorizing a portion of the existing fixed cost contribution as environmental cost recovery would reduce the remaining fixed cost contribution inherent in the Company's firm base rates, which contribution had already been fully considered in determining the amount of the Company's base rate increase. (Id. at 11). Consequently, the Company proposed that the costs of the remediation rider be allocated only to firm customers. It noted, however, that this issue was more appropriately considered in the rate design phase of this docket. (Id. at 12).

87 The Company next argued that the Hearing Examiner inappropriately denied recovery of the remediation costs associated with the Smyrna site. While admitting that the record evidence concerning the Smyrna site was "limited," the Company asserted that the greater magnitude of the costs for the Dover Site warranted it being the focus. (Id. at 12). It contended that the Commission could authorize recovery of the Smyrna costs based on the evidence presented. (Id.). If, however, the Commission believed that additional information about the Smyrna costs would be

helpful, the Company requested the Commission to authorize Chesapeake to defer those expenses to an appropriate account for consideration in its next base rate proceeding. (Id. at 14).

88 The Company stated that if the Commission approved the implementation of a rider mechanism to recover environmental expenses, Chesapeake did not except to the Hearing Examiner's refusal to include its projected environmental expenses in prospective rates. The Company, however, disputed the Hearing Examiner's conclusion that the record did not establish that the estimates were conservative or a "worst case scenario." (Id. at 14-15).

89 Finally, the Company stated that it did not except to the Hearing Examiner's recommended seven-year amortization period if the Commission authorized base rate treatment for the unamortized balance of the remediation expenses. (Id. at 15). If rate base treatment was denied, however, the Company contended that the appropriate amortization period was five years. (Id.).

VI. SUBSEQUENT EVENTS

90 After receiving the parties' exceptions, the Hearing Examiner attempted to clarify his recommendation concerning the appropriate allocation of the costs of the remediation rider. (Letter dated November 9, 1995 from The Honorable G. Arthur Padmore to the Chairman and Members of the Commission, copies of which were provided to all parties for responses, if any, by November 16, 1995). The Hearing Examiner explained that he was recommending that the costs be spread "equally among all of Chesapeake's approximately 15,900 customers so that each Chesapeake customer, regardless of classification, would pay an equal share of the remediation expenses to be amortized." (Id. at 1) (emphasis in original). He attached to his letter a schedule illustrating the operation of his recommended allocation. (Id. at Attachment A).

91 The Hearing Examiner also responded to the OPA's request for clarification of his recommendation for recovering the remediation expenses. (Id. at 2). He wrote that he had recommended: (1) a seven-year amortization of "Chesapeake's actually incurred annual net remediation costs associated with the Dover site;" (2) implementation of the amortization through a rider mechanism; and (3) no rate base treatment of the unamortized remediation balances. (Id.) (emphasis added).

92 All parties responded to the Hearing Examiner's clarification. The Company argued that the 50/50 sharing espoused by the OPA was contrary to the Hearing Examiner's recommendations and should be rejected. (Letter dated November 16, 1995 from William A. Denman, Esq. to the Chairman and Members of the Commission at 1-2). Hence, the Company argued, the associated deferred taxes should not be used to reduce the amount of remediation costs to be amortized because the unamortized balance was not being included in rate base. (Id. at 2). Rather, according to the Company, "[t]he party who bears the expense of the carrying costs associated with the unamortized environmental expenses should get the benefit of the deferred taxes." (Id.). The Company also reiterated its position that the costs of the remediation rider should be allocated only among its firm customers. (Id.).

93 The OPA pointed out that the Hearing Examiner's recommendation, as clarified, would result in ratepayers absorbing 70% of the remediation costs and stockholders bearing only 30% of the costs. (Letter dated November 9, 1995 from Patricia A. Stowell to the Chairman and Members of the Commission at 1). The OPA reaffirmed its position that a 50/50 sharing of these costs was most appropriate under the circumstances presented in this docket, and urged the Commission to modify the Hearing Examiner's recommendations in whatever way necessary to

achieve that result. (Id. at 2). The OPA also contended that the Hearing Examiner's recommended allocation of the remediation rider equally among all customers would unfairly burden residential and small commercial customers, and noted that heating and non-heating customers would pay the same amount. (Id. at 2-3). Consequently, the OPA argued, the Commission should adopt a methodology allocating remediation costs on the basis of throughput or, alternatively, direct the parties to present a rate design recommendation at the time the initial rider was implemented. (Id. at 3).

94 Staff reiterated its position that the parties investigate alternative allocation methods and report their findings to the Commission so as to enable it to make an informed decision as to the appropriate allocation. (Letter dated November 16, 1995 from Regina A. Iorii, Esq. to Bruce H. Burcat, Esq., Executive Director, at 1). With respect to the recovery of remediation costs, Staff pointed out that under its proposed methodology, the remediation costs would be allocated approximately equally between ratepayers and stockholders, because the effect of the deferred taxes is considered in the calculation of the annual amortization amount under Staff's proposed recovery mechanism. (Id. at 1-2).

95 At the November 21, 1995 meeting, Chesapeake suggested during oral argument that it be permitted to apply a $454,000 refund from its pipeline supplier to reduce the amount of unrecovered remediation expenses. (11/21/95 Tr. at 317, 333). The OPA and Staff objected to the Company's suggestion, arguing that that refund was not an issue in the rate case. (Id. at 324, 332-33). In addition, Staff pointed out that it would violate 26 Del. C. §303(b) if the refund of fuel costs was used to reduce the amount of outstanding remediation costs. (Id. at 333).

VII. FINDINGS AND OPINION

A. THE STIPULATION

96 For the reasons expressed by the Hearing Examiner, we find that the Stipulation, which resolved all of the issues in this docket except for the treatment of environmental remediation costs, is just and reasonable. 26 Del. C. §303(a). The Stipulation, which results in a $900,000 additional revenue requirement for the Company, was agreed to after both the Staff's and OPA's witnesses had investigated the issues and had derived revenue requirements very close to the amount reflected in the Stipulation. Like the Hearing Examiner, we too are persuaded by the fact that the OPA, who is statutorily obligated to advocate the lowest possible rates consistent with adequate service and equitable rate distribution, supports the Stipulation. We further note that by approving the Stipulation, we are avoiding the need for continued costly litigation of the numerous revenue requirement issues that are subsumed within the Stipulation, and that the Stipulation's result is in the public interest. 26 Del. C. §512. While we may have decided the issues differently from the way in which they have been resolved in this Stipulation had we considered each issue individually, our approval of this Stipulation does not preclude us from revisiting any of the issues encompassed therein in future rate cases, and the Stipulation creates no precedent to which this or any future Commission is bound in future cases. Hence, we find the Stipulation to be in the public interest, and hereby approve it.

97 We note that the Stipulation provides that the rates shall become effective with usage on and after December 1, 1995. That date has already passed, however, and we cannot approve rates to become effective retroactively. Thus, we hold that the rates approved in this docket shall become effective for usage on and after January 1, 1996.

B. REMEDIATION EXPENSES

1. The Smyrna Site

98 We reject the Hearing Examiner's recommendation to deny the Company recovery of the costs incurred in connection with the Smyrna site. Although we recognize that the Hearing Examiner concluded that the Company had not met its burden of proof for recovery of these expenses, and we too are uncomfortable with the sufficiency of the evidence presented in support of recovery of those expenses, we nevertheless conclude that the Company's request to defer the Smyrna expenses to an appropriate account for future consideration should be granted. We therefore authorize the Company to record the remediation costs associated with the Smyrna site in a separate account and to defer the Commission's consideration of the appropriate ratemaking treatment of those costs for future consideration. In this regard, however, we remind the Company that under 26 Del. C. §307(b) it has the burden of proving that these expenses are recoverable.

2. The Dover Site

99 We agree with the Hearing Examiner that it would not be appropriate to include in base rates the projected amounts of environmental expenses. This Commission has permitted expenses that will be incurred outside of the test period, or items that will be placed into service outside of the test period, to be included in operating expenses or rate base for the purpose of establishing rates when it is reasonably certain that the expense will be incurred or the item will be placed in service during the rate effective period and where the amounts associated therewith are sufficiently ascertainable. Thus, for example, we have approved post-test period adjustments for such items as wage increases that are contractually scheduled to become effective during the rate effective period, and we have approved the inclusion in rate base of equipment that will be placed

into service shortly after the close of the test period. See, e.g., Delmarva Power & Light Co., Docket No. 91-20, Order No. 3389.

100 The record demonstrates that the amounts Chesapeake has projected for remediation are not sufficiently known and measurable to be included in current rates, and, moreover, that it is likely that the full amount of those projected costs will not be incurred within the rate effective period. Furthermore, the record evidence demonstrates that Chesapeake's ultimate liability for remediation costs may very well be reduced by contributions from the State of Delaware and other potentially responsible parties, and by a modification of the level of soil remediation required by the ROD, for which Chesapeake and the State of Delaware are negotiating with the EPA.

101 Finally, we find that Re Iowa Southern Utilities Company, Docket No. RPV-89-7 (Iowa Util. Div., Sept. 14, 1990) is distinguishable. In that case, the Iowa Commission permitted the utility to include in its revenue requirement a representative amount of remediation expenses consisting of the average of actual 1989 costs and estimated 1990 and 1991 costs. The Company here, however, seeks to include the entire amount of estimated costs -- which we have already determined to be too uncertain and speculative -- in its prospective rates.

102 We approve the Hearing Examiner's recommendation that Chesapeake be permitted to recover its reasonable, actually-incurred remediation expenses, reduced by any recovery from insurance proceeds or from third parties. The record demonstrates that the actions that led to Chesapeake's responsibility for remediating the Dover site occurred many years ago, long before CERCLA was enacted. We believe it would be unfair to hold the Company liable for lacking the clairvoyance to foresee the passage of CERCLA. In addition, we note, as did the Hearing Examiner,

that neither Staff nor the OPA are advocating that recovery of remediation costs be disallowed completely.

103 We further approve the Hearing Examiner's recommendation that the Company's reasonable, actually-incurred remediation expenses should be recovered through a rider mechanism that is adjusted on an annual basis. We believe it will advance administrative efficiency to collect these costs through a rider, as this will eliminate the need to adjust base rates when there is a change in the amount of remediation costs. We also approve the Hearing Examiner's recommendation to conduct the annual review of the remediation rider in connection with the Company's purchased gas adjustment proceeding. This too will promote administrative efficiency in that it will negate the need for an additional administrative proceeding.[19]

104 We wish to make clear that notwithstanding the fact that the remediation rider will be considered and adjusted at the same time and in the same proceeding as the Company's purchased gas adjustment, the two are to be maintained, tracked, and addressed separately. The Company shall not apply any refunds it receives from its pipeline suppliers to reduce the amount of remediation costs to be recovered during any particular year. Nor shall there be any other combination of gas costs or refunds with the remediation costs.

105 We also approve the Hearing Examiner's finding that these expenses are extraordinary and, as such, should be amortized over a number of years rather than included in

[19] We note that under Chesapeake's current tariff, it is required to apply for a change in its purchased gas adjustment every May and November to become effective on June 1 and December 1 of each year.

operating expenses for recovery through rates. As the Hearing Examiner explained, these are not ordinary operating expenses, such as salaries and wages, that the Company uses for its day to day operations; that is, they are not recurring expenses in the utility's day to day operations. They are, rather, extraordinary expenses, thrust upon the Company by a change in the law that created liability where there previously had been none, and thus are more properly deemed unexpected. This Commission has consistently followed the practice of amortizing extraordinary expenses over a number of years, and we have not been presented with a persuasive reason to abandon that practice here.

106 The Hearing Examiner recommended that the Commission amortize the remediation expenses over seven years, with no rate base treatment for the unamortized balance, and apparently with the benefit of the deferred taxes accruing to the Company. While we approve the Hearing Examiner's recommendation that no rate base treatment be afforded the unamortized balance, we believe that a more appropriate amortization period is five years, as proposed by the Company in its exceptions. This is also the amortization period that we approved for the Company's remediation expenses at issue in Docket No. 85-17.

107 With respect to the associated deferred taxes on the unamortized balance, we hold that the ratepayers should be given the benefit of those taxes, since pursuant to our decision the ratepayers will be bearing greater than 50% of the remediation costs. In addition, Staff notes that under the Massachusetts formula, the rate base value of the deferred taxes associated with the unamortized balance is automatically deducted from that year's amortization.

108 As noted previously, we approve the Hearing Examiner's recommendation to deny rate base treatment to the unamortized balance of the remediation costs. We believe that under the

circumstances, it would be inequitable and unjust to require the Company's ratepayers to shoulder the burden of not only paying for all reasonable, actually-incurred costs, but also paying a return on those costs. First, we note that under Delaware law, property to be included in rate base must be "used and useful" in the provision of utility service. 26 Del. C. §102(3)a. Here, it is undisputed that the land to which these expenses relate is no longer used and useful in providing utility service to Chesapeake's customers, nor, since it is owned by the State of Delaware, will it ever be used and useful in providing such service. While we acknowledge that some commissions have permitted utilities to collect from ratepayers the carrying costs on the unamortized balance of remediation costs even where the land to which the expenses relate was not owned by the utility, we observe that other commissions have denied such treatment even where the land was still owned and used by the utility to provide service. We also note that in authorizing Chesapeake to recover carrying costs on the unamortized balance of remediation costs, our sister commission in Maryland emphasized repeatedly its reliance on the fact that the land there was currently used by Chesapeake to provide utility service.

109 Although we are authorized by 26 Del. C. §102(3)g to include in a utility's rate base any element of property which in our judgment is necessary to the utility's effective operation, we are not persuaded that carrying costs on the Company's unamortized balance are necessary to the Company's effective operation. The Company did not present any evidence during this case that it would be unable to provide service if carrying costs were denied, nor did it establish that its financial integrity was being threatened from its inability to recover carrying costs. The only testimony in this regard addressed what might happen in the future if certain events occurred. This, we believe, is too

slim a reed on which to conclude that carrying costs are necessary to the Company's effective operation.

110 Moreover, in this regard, we approve the Hearing Examiner's recommendation that if at some future time the Company convinces the Commission that the unamortized balance has reached such a level as to threaten to impair the Company's financial integrity, the Commission may consider authorizing the Company to earn its short-term debt rate on the amount of the unamortized balance that exceeds a certain level. We do not believe that the Company's unamortized balance has yet reached such a level; indeed, as we noted, there was no evidence that the Company's financial health is currently being impaired. We do recognize, however, that is a legitimate concern, and believe our decision here adequately addresses that particular concern.

111 We also reject the Company's request to include the unamortized balance of remediation expenses in rate base because we believe that equity requires Chesapeake's stockholders to bear some of the burden associated with those expenses. The Company's stockholders are routinely compensated for unforeseen risks such as these through the return on equity. While we are sympathetic to the Company's argument that as a regulated utility it is not entitled to earn more than its authorized rate of return, it is also true that, as Staff argued, an unregulated company lacks the captive customer base from which to recover such costs that Chesapeake has, and thus risks having to absorb those costs entirely. Furthermore, the fact remains that the return on equity which the Commission authorizes is designed to compensate investors for risks. Lastly, we note that the Company will sustain no actual book loss if it is denied carrying costs on the unamortized balance. Since Chesapeake will recover its actual expenses, the absence of carrying costs on the unamortized balance will not result in any charge to operating income.

112 Finally, on this issue, we see no reason to depart from our previous decision in Docket No. 85-17, in which we also denied rate base treatment of the unamortized balance, while permitting recovery of actual costs over five years. There, we noted our belief that denial of rate base treatment of the unamortized balance was "a fair balance between the interest of the ratepayers and the stockholders." (Order No. 2728 at p. 6, ¶ 12). We adhere to that belief today. While Chesapeake cannot be blamed for the incurrence of these costs, neither can its ratepayers. Hence, considering the statutory definition of rate base, the record evidence, and the equities involved, we believe that the most appropriate decision is to allow the Company to amortize its actually-incurred expenses over five years, and to deny rate base treatment for the unamortized balance.

113 We observe that our decision here, while apportioning the responsibility for remediation costs between both the Company's stockholders and ratepayers, actually assigns a greater part of the responsibility to Chesapeake's ratepayers. We believe this apportionment is in the public interest, however.

114 Turning to the issue of the Docket No. 93-20 unamortized balance of remediation costs, we approve the Hearing Examiner's recommendation to deny carrying costs on those expenses for the reasons we have previously expressed. In addition, we note that the Company is requesting the Commission to grant it recovery of past costs. This, we believe, is prohibited in this state. See Public Service Commission v. Diamond State Telephone Co., 468 A.2d 1285, 1298 (Del. 1983).

115 Finally, it became apparent during the oral argument and our deliberations that we did not have a sufficient basis for making an informed decision on the Hearing Examiner's recommendation to allocate the costs of the remediation rider on a per-customer basis. Therefore, we instructed the parties to investigate alternative methods of allocating the costs of the remediation

rider and to report back to us. After such investigation, the parties have proposed to allocate the costs of the remediation rider among all firm service customers on a per CCF basis. We find that such an allocation method is reasonable and in the public interest, and hereby approve it.

VIII. ORDER

AND NOW, this 19th day of December, 1995, based on the affirmative votes of Chairman McMahon and Commissioners Norling, Twilley and Hartley on November 21, 1995,

IT IS HEREBY ORDERED:

1 That the Stipulation and Agreement, which is attached hereto as Exhibit A and incorporated by reference herein, which results in a $900,000 increase to the Company's revenue requirement and which encompasses all revenue requirement issues that were or could have been litigated except for the appropriate treatment of the Company's environmental remediation costs, is approved.

2 That the Company is authorized to record the environmental remediation costs associated with the Smyrna site into a separate account and to defer the Commission's consideration of the appropriate ratemaking treatment of those costs to a future proceeding.

3 That the Company's request to recover in prospective rates its projected environmental expenses for the Dover Site is denied.

4 That the Company is authorized to recover its reasonable, actually-incurred net environmental expenses for the Dover Site through amortization over five years, with no rate base treatment of the unamortized balance, and reduced by the associated deferred income taxes. Each year's annual remediation expenses shall be placed in a separate pool and amortized over a five-year period.

5. That the Company is authorized to recover the total annual net remediation costs to be amortized by means of a rider to base rates. The rider shall be applied to all firm service

customers on a per-ccf basis. The rider shall be identified on customers' bills as a separate line item.

6. The amount of remediation costs claimed by the Company through September 30, 1995, the Company's test period in this proceeding, is $564,514 ($499,767 net of deferred income taxes). The Company is authorized to begin recovery of its remediation expenses incurred through September 30, 1995 on January 1, 1996, subject to review of the reasonableness of those expenses by Staff and the OPA and subject to refund if any of the expenses are deemed by the Commission not to be reasonable. Thereafter, the amounts to be recovered each year through the rider shall be reviewed and adjusted annually in conjunction with the Company's purchased gas cost adjustment proceeding, beginning with the Company's November 1996 purchased gas adjustment filing and continuing every year thereafter until all remediation costs have been recovered. The Company shall identify in its filing the amount of expenses to be amortized over the following year and shall provide satisfactory proof of their reasonableness.

7. That the Company's request for rate base treatment of the unamortized balance of the remediation costs approved for recovery in Docket No. 93-20 is denied.

8. That, if the Company can establish to the Commission's satisfaction in a future review of the annual amortization amount that its unamortized balance has resulted in regulatory assets so large as to threaten the Company's financial integrity, the Commission will consider appropriate remedial action.

9. The rates authorized herein shall be effective for service rendered on and after January 1, 1996.

BY ORDER OF THE COMMISSION:

/s/ Robert J. McMahon
Chairman

/s/ Joshua M. Twilley
Commissioner

/s/ Robert W. Hartley
Commissioner

_____
Commissioner

_____
Commissioner

ATTEST:

/s/ Linda A. Mills
Secretary

20403.1

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF THE DELAWARE DIVISION OF CHESAPEAKE UTILITIES CORPORATION FOR A GENERAL INCREASE IN NATURAL GAS RATES AND CHARGES THROUGHOUT DELAWARE AND FOR APPROVAL OF OTHER TARIFF CHANGES (FILED APRIL 4,1995)	))))))	PSC DOCKET NO. 95-73

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

DATED: NOVEMBER 1,1995

G. ARTHUR PADMORE HEARING EXAMINER

TABLE OF CONTENTS

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF	)	
THE DELAWARE DIVISION OF CHESAPEAKE	)	
UTILITIES CORPORATION FOR A GENERAL	)	
INCREASE IN NATURAL GAS RATES AND	)	PSC DOCKET NO. 95-73
CHARGES THROUGHOUT DELAWARE	)	
AND FOR APPROVAL OF OTHER TARIFF	)	
CHANGES (FILED APRIL 4, 1995)	)	

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

G. Arthur Padmore, duly appointed Hearing Examiner in this docket pursuant to 26 Del. C. §502 and 29 Del. C. Ch. 101 by Commission Order No. 3988, dated April 25, 1995, reports to the Commission as follows:

I. APPEARANCES

On behalf of the Applicant, Chesapeake Utilities Corporation:
SCHMITTINGER & RODRIGUEZ, P.A. BY:
WILLIAM A. DENMAN, ESQUIRE

On behalf of The Office of the Public Advocate:
PATRICIA A. STOWELL, The Public Advocate

On behalf of the Delaware Public Service Commission:
ASHBY & GEDDES
BY: JAMES McC. GEDDES, ESQUIRE & REGINA A. IORII, ESQUIRE,
Rate Counsel

II. BACKGROUND

1. On April 4, 1995, Chesapeake Utilities Corporation ("Chesapeake" or "the Company"), filed with the Delaware Public Service Commission ("the Commission") revised tariffs designed to produce for its Delaware Division, an annual increase of approximately $2,751,189 (or 14.40% of existing revenues), based on a test period ending September 30,1995. After reviewing the Chesapeake application, the Commission determined that, pursuant to 26 Del. C, §306(a)(1), the revised tariffs should be suspended pending evidentiary hearings concerning the justness and reasonableness of the proposed rate increase. With its application, Chesapeake filed the written testimony of its Consultant, Robert S. Jackson (Exh. 2);[1] its Rate Analyst, Holly H. Carroll (Exh. 5); its Senior Vice President of Natural Gas Operations, Philip S. Barefoot (Exh. 9); and its Director of Natural Gas Accounting and Rates, Michael P. McMasters (Exh. 15).

2. On April 25, 1995, the Commission issued Order No. 3988, formally suspending the proposed revised tariffs, initiating this proceeding, and designating this Hearing Examiner to conduct the necessary evidentiary hearings to consider the Chesapeake proposal. Chesapeake published notice of the filing of its application as directed by the Commission's Order. (Exh. 1.)

3. On April 26,1995, pursuant to 29 Del. C. §8829(c), the Public Advocate filed her statutory Notice of Intervention in this docket. No other person intervened in this proceeding.

exhibits entered into the record at the August 30 & 31,1995 hearings will be cited as "(Exh. _)", (Exh. __ (Name of Witness) at __)", or "(Exh. _ at __)". References to the transcript of this proceeding will be cited as "(Tr. at_)".

4. Following informal consultations among the parties and the Commission Staff, a procedural schedule for the conduct of this proceeding was developed, proposed to, and approved by the Hearing Examiner.

5. On June 15, 1995, the Company submitted the supplemental written testimony of Messrs. Barefoot and McMasters (Exh. 10 and 16, respectively)[2] and its Consultant John Bush (Exh. 7).

6. Upon due notice (Exh. 1), a public comment session was conducted on the evening of July 19,1995 in the Commission's Dover office.[3] Representatives of the parties and the Commission Staff were present at the public comment session, but no customer or member of the public appeared.

7. On July 26, 1995, the OPA filed the written testimony of its Principal Assistant, Dr. Rajnish Barua (Exh. 20) and its Consultant, Andrea C. Crane (Exh. 21). Staff presented the written testimony of: its Public Utilities Analysts Susan B. Neidig (Exh. 23) and Vincent 0. Ikwuagwu (Exh. 26); and its Consultants, Richard W. LeLash (Exh. 22) and Richard Koda (Exh. 27).

8. On August 10,1995, Chesapeake filed the written rebuttal testimony of Ms. Carroll (Exh. 6)[4] and Messrs. Jackson (Exh. 3), Bush (Exh. 8), Barefoot (Exh. 12), and

^he supplemental written testimony will be cited as "(Exh. __ (Name-S) at_)".

'The Commission's Public Information Officer also distributed an advance press release concerning the evening public comment session among the local print and broadcast media, and articles concerning the evening session appeared in *The News Journal* and the *Delaware State News* newspapers well before the July 19th public comment session.

"The rebuttal testimony will be cited as "(Exh. __

(Name-R) at__)". 3

McMasters (Exh. 17). In its rebuttal testimony, the Company revised its requested rate increase to $2,390,582, based on updated data. (Exh. 17 (McMasters-R) at 2.)

9. Duly publicized technical evidentiary hearings were conducted on August 30 and 31, 1995 at the Commission's Dover office. Several members of the public, mostly retirees, appeared at the August 30,1995 hearing. A spokesman for the group, Mr. John Maraist, expressed concern that Chesapeake's proposed rate increase is "a little bit beyond outrageous" and questioned whether the Company's proposed 14% rate increase is warranted, in light of his perception that "times are tough for everybody." (Tr. at 9-10.) At the August 30,1995 hearing, the Company sought and was granted leave to participate in informal discussions with the OPA and Staff concerning a possible settlement of the

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issues in this docket. (Tr. at 75-76.)

10. At the August 31, 1995 hearing, the parties and the Staff presented a Stipulation and Agreement ("Agreement" or "Settlement") which proposed to settle all issues in this docket except for the issue concerning the appropriate ratemaking treatment for environmental remediation costs associated with the Dover Gas Light site. (Tr. at 77-78; Exh. 19.) With the exception of Mr. Bush,[5] all of the Company witnesses were cross-examined. OPA witnesses Barua and Crane as well as Staff witnesses Neidig and LeLash presented live testimony in support of the proposed settlement.

11. At conclusion of the evidentiary hearings, the record consisted of 27 exhibits and a 278-page *verbatim* transcript of the hearings. The parties and the Commission Staff

'Although Mr. Bush did not appear at the hearings, his testimony, which was verified by an attached affidavit, was entered into the record without

objection as Exhibits 7 and 8. (See *discussion,* Tr. at 82-84.)

filed initial and answering briefs addressing the remaining disputed matter.[6] I have considered the briefs and the entire record. Based thereon, I submit for the Commission's consideration these Findings and Recommendations.

III. SUMMARY QF EVIDENCE AND DISCUSSION

12. **The Stipulation and Agreement.** As previously noted, at the August 31, 1995 hearing, the parties and the Staff presented a Stipulation and Agreement which proposed to settle all issues in this docket except for the issue concerning the appropriate ratemaking treatment for the remediation costs. In the Stipulation and Agreement, the parties and Staff have recommended an increase in base rate revenue of $900,000 which, they assert, resolves all of the revenue issues in this docket except for the appropriate revenue requirement and ratemaking treatment for environmental remediation expenses. (Exh. 19 at 3, ^1.) Implicit in the stipulated revenue increase is an overall rate of return of 10.12%, which is the product of an 11.50% return on equity on Chesapeake's proposed capital structure of 43.14% long term debt and 56.86% common equity.

13. The Stipulation and Agreement also proposes that rates designed to recover the proposed revenue increase will become effective for usage on and after December 1,

"**The initial and reply briefs shall be cited, respectively, as follows:**

°ln the case of Chesapeake, "(CUC at_J" and "(CUC-R at_J";
°ln the case of the OPA, "(OPA at_)" and "(OPA-R at_)";

and °ln the case of the Commission Staff, "(Staff at _)"

and "(Staff-R at_J". 5

1995. (Jd, at 3, ^1.) In addition, the Settlement encompasses the following revenue requirement issues:

- In determining its revenue requirement in its next base rate case, Chesapeake agrees to use a weather normalization methodology that relies upon weather data for the most recent consecutive 30-year period. In the Company's next base rate proceeding, however, Staff is free to use some other time period, and the Commission may then determine that some other time period is most appropriate. (Id. at 3-4, U2a.)

- The proposed revenue requirement reflects the inclusion in rate base of $1.2 million relating to costs associated with the installation of Chesapeake's new customer information system, to be amortized over 15 years in the annual amount of $80,000. (Id. at 4,1|2b.)

- The proposed revenue requirement reflects the continuation of the amortization of environmental remediation costs approved by the Commission in PSC Docket No. 93-20 in an annual amount of $107,138. As discussed, *infra,* Chesapeake has not withdrawn its request that the unamortized balance be afforded rate base treatment. (]d. at 4, U2c.)

- The depreciation rates approved by the Commission in Chesapeake's prior base rate proceeding shall remain in effect except that effective December 1, 1995, the Company will implement a depreciation rate of 2.85% for Account No. 311 - Liquified Petroleum Gas Equipment. (Id. at 4,113.)

- Chesapeake agrees to affirmatively address the issue of the allocation of overhead costs capitalized to General Plant in its next base rate proceeding. (Id. at 4, ^4.)

14. Chesapeake's initial rate increase request of $2,751,189 included $1,023,000 of revenue requirement associated with environmental remediation expenses. (Id. at 1.) In its rebuttal testimony, the Company modified its revenue requirement to $2,390,592 of which $980,000 represented remediation costs.[7] (Chesapeake at 5.) This translates to a $1,410,582 revenue increase, exclusive of environmental expenses. In their filed written testimony, the OPA and Staff recommended, respectively, revenue increases of $593,888 and $328,000, based on a return on equity of 11 %. (Exh. 19 at 2.)

15. Staff and the parties acknowledge that the Stipulation and Agreement represents a compromise of their respective positions regarding the issues in this docket and, thus, "shall not be regarded as a precedent with respect to any rate making or other principle in any future case." (Jd. at 4.) Moreover, it is explicitly understood that by entering into the Stipulation and Agreement, no party thereto necessarily agrees or disagrees with the treatment of any particular issue other than as specified therein. In addition, the parties agree that the resolution of the issues in the Stipulation and Agreement, taken as a whole, represents a just and reasonable resolution of the revenue requirement issues addressed in the Agreement. (Id. at 4-5.)

16. **Discussion.** Under Delaware law,[8] all utility rates must be just and reasonable. Re Delmarva Power & Light Company. 84 PUR 4th 684, 687 (Del. 1987). Thus, in considering whether or not the Commission should adopt the Setlement and Agreement, the primary focus of this docket should be to determine whether or not the evidentiary record supports a finding that the revenue requirement proposed in the Settlement and Agreement will produce just and reasonable rates. While utility rates

Chesapeake's modified rate request was based on a return on equity of 11.75% ^G Del. C. §303(a).

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should be fair to both the utility and the consuming public,[9] rates are deemed just and reasonable if they are "sufficient to yield a fair return to the utility upon the present value of property dedicated to public use."[10] My review of the record indicates that the rates and proposals agreed to in the settlement agreement are, indeed, just and reasonable and meet the statutory requirements. Moreover, both the Commission Staff and the Public Advocate are parties to and support approval of the agreement. Therefore, for the reasons discussed below, I recommend that the Commission approve the settlement agreement.

17. First, the Staff and the OPA, who is charged with the responsibility of representing the interests of Delaware ratepayers,[11] presented persuasive testimony that the Stipulation and Agreement is in the public interest and should be approved. Staff witness Susan B. Neidig testified that in her opinion, the proposed settlement constituted a fair and equitable resolution of the revenue requirement issues in this case. (Tr. at 277.) She noted that Staff had considered additional closings to plant in service, certain pro forma adjustments, and its recommended return on equity, and that its analysis had yielded a revised revenue requirement increase (exclusive of environmental remediation costs) which approached the $900,000 revenue requirement increase to which the parties had agreed. Moreover, she pointed out, the settlement precludes further litigation of these issues, which would have been costly. (Id.) In addition, OPA witness Andrea Crane, who

In the Matter ofWilminaton Suburban Water Corp.. 367A.2d 1338,1343 (1976).

Delaware Public Service Commission v. Wilminorton Suburban Water Corn.. Del. Supr., 467 A.2d 446, 447(1983).

"Under Delaware law, the Public Advocate has a duty to "advocate the lowest reasonable rates for consumers consistent with the maintenance of adequate utility services and consistent with an equitable distribution of rates among all classes of consumers." 29 Del. £. §8828(2).

8

concurred with the Staff position, testified that she had reviewed the Stipulation and Agreement and found it reasonable. She asserted that the OPA also supports the proposed $900,000 revenue requirement increase, which excludes the recovery of remediation costs. (Id. at 205-206.)

18. Second, as Staff points out on brief, approval of the Stipulation and Agreement would be in keeping with the legislative mandate of the recently enacted 26 Del. C, §512 which provides:

> "(a) Insofar as practicable, the Commission shall encourage the resolution of matters brought before it through the use of stipulations and settlements.
>
> "(b) The Commission's staff may be an active participant in the resolution of such matters.
>
> "(c) The Commission may upon hearing approve the resolution of matters brought before it by stipulations or settlements whether or not such stipulations or settlements are agreed to or approved by all parties where the Commission finds such resolutions to be in the public interest."

19. Lastly, although the Commission may not have decided the revenue requirement issues in the same way in which they were resolved in the instant case, the Commission's acceptance of the settlement does not provide a precedent concerning how this Commission or future Commissions will resolve these same issues in future base rate cases. See Re Minnegasco. Inc.., 143 PUR 4th 416, 424 (Minn. 1993).

Ratemaking Treatment of Environmental Costs

20. **Background.** Chesapeake is a previous owner of property known as the Dover Gas Light Site.[12] From 1859 to 1949, the Dover Gas Light Site was used to manufacture gas prior to the existence of the interstate gas pipelines. (Exh. 22 (LeLash) at 49, Schedule 14.) The Company, through predecessors, owned the property from 1881 to 1949. (Id. at 52.) In addition to the Company, there have been several other owners of the Dover Gas Light Site, including Associated Gas & Electric (subsequently reorganized into General Public Utilities Corporation), Harrison & Company, and the State of Delaware, which purchased the site from the Company in 1949. (Jd, at Schedule 14.) Beginning sometime in the 1950s and ending in 1989, Capital Cleaners and Launderers, Inc. ("Capital") operated a dry cleaning plant on property directly southeast of the Dover Gas Light Site. Capital had at least six underground storage tanks, which it used to store fuel oil, heating oil, gasoline, and chlorinated compounds. (Exh. 21 (Crane) at 11.) Capital also operated a facility directly across the street from the Dover Gas Light Site, at which it had additional underground storage tanks for heating oil, fuel oil and chlorinated compounds. (Id.. at 11-12.)

21. In 1980, the United States Congress enacted the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), 42 U.S.C. §§9601 etseg., in an attempt to clean up property and ground water contaminated by the disposal of hazardous waste. CERCLA imposes joint and several liability for cleaning up the

[12] ^he site is located within the City of Dover, Delaware, on the western half of a city block bounded by New Street, Bank Lane, North Street, and Governors Avenue.

contaminated sites (commonly known as "Superfund" sites) upon current and past owners or operators of a site from which there has been or there is a substantial threat of a release of a hazardous substance into the environment.

22. The disposal of tars, oils, and other by-products of the gas manufacturing process at the Dover Gas Light Site has resulted in contamination of the soil and the ground water. The contamination was first discovered in 1984. Soil tests indicated buried building debris, "oily" samples, and fuel-like odors. (Exh. 21 (Crane) at 12.) The remains of the coal gasification plant were found buried on the site, and the oily soil samples contained significant contamination levels. (Id.) The ground water on the site and southeast of the site was contaminated with several volatile organic compounds (VOCs), including benzene, toluene, ethyl benzene and xylene, and with polynuclear aromatic hydrocarbons (PAHs) such as naphthalene and acenaphthalene. (Id.)

23. In 1991, the Environmental Protection Agency ("EPA") designated the Dover Gas Light Site as a Superfund site. Although the plant itself was only approximately one acre, the entire Superfund site is approximately 23 acres due to the spread of the contamination into the ground water. The contamination from the gas manufacturing process itself is limited to the plant area near the surface. (Id. at 12-13.) Four potentially responsible parties ("PRPs") for the cleanup of the Dover Gas Light Site have been identified: Chesapeake; General Public Utilities ("GPU"); the State of Delaware; and Capital. (Exh. 22 (LeLash) at 54.)

24. The Company claims that since 1985, it has spent more than $2.7 million on site investigation. (Exh. 21 (Crane) at 14.) In July 1990, it entered into an Administrative

Consent Order with the EPA and the State of Delaware Department of Natural Resources and Environmental Control ("DNREC"), in which the Company agreed to conduct a remedial investigation and feasibility study ("RI/FS") to determine the nature and extent of the contamination at the site and to screen, develop, and evaluate potential remedial options. The RI/FS was completed in June 1993. Following the RI/FS, the EPA issued a Record of Decision ("ROD") in August 1994. The ROD required:

1. Removal of soil and other contaminant-source material at the Dover Gas Light Site (consisting of removing, treating, and disposing of the contaminated soil off-site in order to return the site to such a condition that it could be used as a parking lot or for expansion of the Delaware State Museum located on part of the site).

2. Installation of a line of recovery wells in the off-site groundwater plume to prevent continued migration of the contaminants.

3. Installation of other wells within the groundwater plume to extract any concentrations of contaminants.

4. Investigation by Capital, pursuant to state supervision, of the chlorinated solvents in the groundwater.
5. Installation of wells for monitoring groundwater

clean up. (Id. at 14-15.)

25. The total estimated present value cost of these actions is $5.1 million: $3.3 million for soil remediation and $1.8 million for groundwater remediation. (Jd. at 15; Exh. 18 at Revised Exh. MPM-5; Exh. 22 (LeLash) at Schedule 13.) However, the costs will not be incurred all at once. According to Mr. Barefoot, the Company's chief policy witness on the remediation issue, expenditures for soil remediation would be made over two years, while expenditures for groundwater remediation could be made over as long as

30 years. (Tr. at 98.) Additionally, implicit in this ROD was the assumption that the property would be developed and used in a particular manner. (Tr. at 89-90.) The State of Delaware, however, has agreed not to develop the property. (Exh. 21 (Crane) at 25.)

26. On May 17, 1995, the EPA issued a Section 106 order requiring the Company and GPU to implement the remedy established in the ROD. (Exh. 10 (Barefoot) at 1.) The Company, however, has not yet begun to implement the remediation work specified in the ROD. Instead, it is currently negotiating with the EPA to reduce the level of the soil remediation required, which would lower the estimated cost of compliance from $3.3 million to $1.0 or $1.5 million. (Tr. at 98.) Furthermore, the State of Delaware is negotiating with the EPA to resolve its responsibility for the site. If a settlement is reached, any payment by the State would reduce the Company's exposure. (Tr. at 137-138.) The same is true with respect to GPU, another PRP with whom the Company is currently negotiating. (Tr. at 138-139.)

Positions of the Parties

27. **Chesapeake Utilities.** Chesapeake seeks to recover, either through a surcharge or as part of its operating expenses, present and projected costs associated with the investigation and remediation of certain claims arising out of the operation of two Manufactured Gas Plant (MGP) sites located in Dover and Smyrna, Delaware. The Company's environmental expense claim consists of three components: (a) PSC Docket No. 93-20 costs; (b) PSC Docket No. 95-73 costs; and (c) EPA ROD soil and groundwater remediation costs. First, with respect to Docket No. 95-30 costs, Chesapeake seeks to revisit the ratemaking treatment that the Commission approved for remediation costs which

were at issue in that Docket. In that proceeding, the Commission authorized the Company to amortize $749,971 over seven years, with no rate base treatment for the unamortized portion. In this case, Chesapeake seeks to continue this amortization but also wants the Commission to include the unamortized balance of $491,052 in rate base. (Exh. 15 (McMasters)atlO.)

28. Second, with respect to this docket, the Company seeks approval of the amortization of a total of $502,642, representing "actual and forecasted costs through the end of the test period for the Dover Gas and Smyrna sites." (CUC at 17-18.) Chesapeake proposes to amortize these costs over five years and to include the unamortized balance in rate base. (Id. at 18.)

29. Third, the Company is requesting a 15-year amortization of an estimated $3.3 million of soil remediation costs and a 30-year amortization of an estimated $1,827,000 in capital costs associated with the groundwater remediation. (jd,) Chesapeake also seeks to have these unamortized balances included in rate base. (Id.)

30. The Company also proposes to credit against the unamortized balance of these expenses any ROD-related amounts which it recovers from third parties. (Id.)

31. The annual revenue requirement associated with the Company's proposed ratemaking treatment of remediation costs is $969,780. (Exh. 18 - Revised Exh. MPM-5.) This revenue requirement is in addition to the $107,138 per year already being recovered in the Company's rates as a result of the Commission's decision in Docket No. 93-20.

32. Chesapeake contends that, with few exceptions, most regulatory Commissions which have considered the issue have concluded that environmental

14

expenses incurred by gas utilities due to the operations of manufactured gas plants are recoverable in rates. (CUC at 19.) Thus, according to the Company, there is little dispute that these expenses are recoverable. (Id.) What is at issue, however, is the appropriateness of the OPA and Staff proposals that Chesapeake shareholders "share" these expenses with the Company's ratepayers by the Commission's denial of rate base treatment for the unamortized balance of the remediation expenses.

33. Staff has proposed that the Commission adopt the so-called "Massachusetts settlement" methodology which requires the amortization of the environmental expenses over a seven-year period without rate base treatment. Chesapeake contends that Staff has neglected to take into account the fact that the Massachusetts settlement permitted the shareholders to retain one-half of insurance and third party recoveries. (]d. at 20-21, citing Exh. 22 (LeLash) at Appendix "A", pages 8-9.) In this instance, however, the Company contends that the proceeds received from its insurance carriers have already been credited against remediation expenses "on a dollar-for-dollar basis." (]d. at 21.) Thus, if the Massachusetts methodology is adopted in Delaware, then 50% of the net insurance proceeds received by the Company, as well as 50% of any funds or benefits obtained by the Company from other potentially responsible parties, should be returned to its shareholders to offset the loss of carrying charges. (Id.)

34. Furthermore, the Company contends, under the terms of the Massachusetts settlement, the total annual charge to a utility's rate payers for environmental expenses during any year may not exceed 5% of the utility's total revenues from firm gas sales during the preceding calendar year; and if the 5% cap results in a utility recovering less

15

than the amount that would otherwise be recovered under the agreement, the utility is permitted to recover carrying charges on the uncollected amounts at the utility's net capital cost rate. (Id.) In addition, under the Massachusetts settlement, a utility may opt out of the settlement if unrecovered environmental expenses exceed the lesser of $2,000,000 or 5.5% of its 1989 firm gas distribution revenues.[13] (Id.)

35. Chesapeake also discusses several cases from other jurisdictions initially cited by Staff witness LeLash, which, the Company asserts, confirm the proposition that recovery of these expenses through rates, without any sharing thereof by shareholders, is appropriate, (id. at 20-27.) In addition, Chesapeake asserts that at least one Commission has permitted the recovery of forecasted remediation expenses. (Id.. at 26-27.)

36. The Company acknowledges that although the unamortized environmental expenses do not fit neatly into any historical "rate base" item, the Delaware General Assembly perhaps recognized the difficulty of listing all components of a utility's rate base because, under 26 Del. £. §102(3)(g), it authorized the Commission to include as a part of a utility's rate base:

> ". . . any other element of property which, in the judgment of the Commission, is necessary to the effective operation of the utility."

Chesapeake, therefore, contends that a disallowance of its proposal concerning rate base treatment of the unamortized balance of remediation expenses will have a major and

[13] Chesapeake asserts that if the Massachusetts settlement were adopted in Delaware, it could very well opt out such an arrangement because its environmental expenses, incurred as of July 31,1995, represent approximately 6.34% of the Company's 1994 firm sales revenues. (CUC at 21-22, citing Exh. 18 at 2.)

adverse impact upon the Company's Delaware operations; thus, Commission approval of its proposed ratemaking treatment of the unamortized balance of the environmental expenses is "necessary to the effective operation" of the Company. (Id. at 28.) In addition, Chesapeake argues, in order to fund its environmental obligations, it must obtain needed capital either in the form of debt or equity, and it is unreasonable to expect either lenders or equity investors to advance funds to the Company to fund its environmental obligation if the Company is not afforded an opportunity to recover in rates the cost of those invested funds. (Id.)

37. The Company urges rejection of the Staff recommendation that these environmental expenses be shared by ratepayers and shareholders because such a procedure ignores regulatory precedent in Delaware which "requires the Commission to allow the utility the opportunity to recover the full amount of its legitimate operating expenses." (Jd.) According to the Company, it is required to operate efficiently, given "the highly competitive marketplace where it offers its services." (Id.) Chesapeake contends that denying it rate base treatment of the MGP remediation expenses will add to costs and produce no direct increase in throughput, thus, adoption of the Staff proposal will impair the Company's "competitive position." (Id.)

38. Lastly, with respect to the Staff and OPA assertions that the Company's shareholders have already been compensated through its return on equity for the risks associated with the environmental expenses, Chesapeake contends that there is no evidence that it has historically been authorized to earn a premium to take into account unknown environmental liabilities. (Id. at 35.) Moreover, the Company argues, the

17

Delaware Courts have established that the Commission is required to allow a utility to recover, through rates, legitimate operating expenses incurred by the utility during the test period and is not authorized to "discount those expenses on some 'equitable' basis as suggested by Staff and OPA." (Id.)

39. Turning to the contention that the remediation costs are not known and measurable and are, therefore, too speculative to be recovered through rates, the Company acknowledges that these costs are "estimates" but argues that they are "the very same estimates included in the ROD," and since the Company has presented testimony that these estimates are "probably conservative to meet [its] needs," it would be "unreasonable" to limit recovery in this docket to an amount that is known to be inadequate. (Id. at 36.) Chesapeake, thus, recommends that the Commission allow recovery of its estimated costs and to the extent that there are overcollections, an appropriate procedure can be implemented to refund any overcol lection to the rate payers.

(Id.)

40. **The Office of the Public Advocate.** The OPA took issue with the Chesapeake proposal to include in rate base the unamortized balance of the remediation costs approved for rate recovery in Docket No. 93-20. (Exh. 21 (Crane) at 21.) The OPA contended that the Company had demonstrated no reason why the Commission should revisit its decision in that docket, and so recommended continuing the ratemaking treatment that had been previously approved in Docket No. 93-20. (Id.)

41. With respect to the costs incurred by the Company through the rate effective date, the OPA recommended that the Company be permitted some recovery of these

costs, but that the responsibility for these costs be shared between the ratepayers and the stockholders. (Id. at 21-22.) The OPA proffered three reasons for this approach. First, according to the OPA, ratepayers had nothing to do with the events that caused the site to become contaminated, and thus there was no reason why they should be forced to fund all of the remediation costs. Second, the OPA noted that the Company's stockholders have been compensated for both financial and business risk through the return on equity granted by the Commission, which return generally represents a premium over the risk-free return. Consequently, the OPA argued, "[i]t would be illogical and unfair to ignore this premium now that the Company is in fact facing a situation that results in some risk." (Id. at 22.) Third, the OPA observed that because the actual contamination of the site occurred before the Company became subject to Commission regulation, asking today's ratepayers to fund the cost of remediation caused by activities that took place prior to regulation violated the regulatory compact between the Company and current ratepayers.

(Jd.)
42. Thus, the OPA recommended that the Company be permitted to recover half of the net present value of these costs, amortized over ten years, with no rate base treatment of the unamortized balance. (]d. at 23.) This recommendation results in an annual recovery of $25,695. (Id.)[14] The OPA also recommended that if the Commission selected a different amortization period, the annual amount to be amortized should be

^PA witness Crane explained that recovery of $25,695 per year for 10 years results in total nominal recovery of $256,950, which, when discounted to present value, has a net present value of $159,957 (half of $319,911). (Exh. 21 (Crane) at 23-24, Schedule 24.)

adjusted to ensure that the Company recovers only 50% of these costs on a net present value basis. (]d. at 24.)

43. Lastly, with respect to the estimated costs of soil and groundwater remediation contained in the EPA ROD for which the Company sought recovery, the OPA contended that none of these costs should be included in base rates at this time. (]d. at 24, 27-28.) First, the OPA claimed, the ROD remediation costs were excessive in light of the fact that the State of Delaware will not be developing the property. (]d. at 25.) Second, the OPA asserted there were "strong indications" that the actual remediation costs may be far less than those reflected in the ROD.[15] Third, according to the OPA, the Company would not incur these costs during the test period. Because the test period ends in September 1995, the OPA noted that it would be "virtually impossible" for the Company to incur any of these costs during the test period. (Id. at 25-26.) Fourth, there were other PRPs who may be responsible for these remediation costs who had not yet accepted responsibility. (Id. at 26-27.) Thus, not only was there uncertainty with respect to the ultimate level of required remediation, but there was also uncertainty about the Company's ultimate share of the cost responsibility. In addition, insurance proceeds and/or recovery of damages from the State of Delaware and Capital could further reduce the Company's remediation expenditures. (Id. at 27.)

44. The OPA characterized as "astonishing" the Company's claim concerning the Smyrna site. (OPA-R at 4.) The OPA contended that not only had Chesapeake failed to

"The OPA^ibserved that the Company had submitted alternative proposals to the EPA that would significantly reduce remediation costs, and the Company was negotiating with the EPA to reduce the level of remediation established in the ROD. (Id. at 25)

provide any record support for these Smyrna costs, but the Company had also failed to provide a description of the Smyrna site and the history that gave rise to the current need for remediation. (]d.) The OPA, therefore, recommended that recovery of costs associated with a site in Smyrna be disallowed for lack of evidentiary support in the record of this docket. (Jd.)

45. **The Commission Staff.** Staff also contested Chesapeake's proposed ratemaking treatment for remediation costs. According to Staff witness Lei-ash, because of the "extreme variability of expenditures and reimbursements," the Company's requested amortization should be limited to actual net expenses to avoid excessive under- or over-recoveries. (Exh. 22 (LeLash) at 52.) Arguing that the Company's remediation expense estimate represented the "worst case scenario," Mr. LeLash contended that the Company had failed to consider several factors which would mitigate a substantial portion of its claim. (Id. at 51.)

46. First, he pointed out, the State of Delaware appeared to be close to settling the EPA's claim against it, which would reduce the amount of remediation costs that the Company would have to pay. Second, a modification to the ROD could reduce the soil remediation costs by more than $2 million. Third, the Company did not include any allowance for outstanding claims against other PRPs, despite substantial expenditures incurred in pursuit of such claims. Lastly, even if they were not modified, the expenditures necessary to meet the ROD requirements would extend over a longer time period than that assumed by the Company. (Jd. at 51-52.) By omitting these factors, Mr. LeLash contended, Chesapeake was overstating its estimated remediation expenses and was

asking ratepayers to pay an amortization that was likely to exceed the Company's net out-of-pocket expenditures, (id. at 52.) In addition, he observed, the Company's estimated amortization could increase ratepayer charges by more than 5%, which is an annual limit deemed by many local distribution companies as reasonable for recovery of remediation costs, (id.) Staff witness LeLash also testified that he was not aware of any Commission that currently allowed recovery of forecasted remediation expenses. (Id.)

47. In addition, Staff noted that other PRPs had been identified as having responsibility for the contamination at the Dover Gas Light Site. (Id, at 54.) Furthermore, Mr. LeLash noted that there was a potential for insurance reimbursement of remediation costs and that the Company had already received some reimbursement from its insurers. (Id. at 54-55.) According to Mr. LeLash, the Company should be investigating ways to reduce the costs of remediation, such as: awarding remediation work to independent contractors on a least-cost basis; seeking reimbursement of remediation expenses from insurers; investigating new interpretations being applied to comprehensive general liability policies in order to determine whether there are any additional grounds for pursuing claims against its insurers; exploring opportunities to modify remediation requirements; seeking to simplify the investigation and survey requirements (as was done by a gas company in New Jersey); and reducing remediation costs based on the source of capital employed to fund those costs. (Jd. at 55-57.)

48. With respect to the issue of who should bear the costs of remediation, Staff contended that it was relevant to consider the reasonableness of past actions and that since there is no indication in the record developed in this case that the Company's

predecessors' operations at the site were reasonable, no conclusion should be drawn as to: (a) the reasonableness of those activities or (b) whether such activities conformed to then existing industry standards. (Id. at 59; Staff-R at 8-9.) Staff, nonetheless, acknowledged that because of the general lack of records covering the period when gas was manufactured at the Dover Gas Light Site, it is nearly impossible to assess the reasonableness of actions during that time.

49. Because of the difficulty in reaching conclusions concerning the reasonableness of past actions, Mr. LeLash noted that several regulatory commissions had adopted an approach that allocated the remediation costs between the stockholders and the ratepayers without making a specific factual finding as to reasonableness. (Exh. 22 (LeLash) at 58.) Staff recommended, therefore, that the Commission consider such "sharing"[16] as an alternative to attempting to assess the reasonableness of the Company's actions during historic periods.[17] (Id. at 59-62)

50. In determining the proper allocation of remediation costs between shareholders and ratepayers, Staff contended that the Commission should consider issues of equity, incentive and regulatory precedent. (Id. at 59.) With respect to regulatory

^As Mr. LeLash testified during the evidentiary hearing, "sharing" is somewhat of a misnomer, since under Staff's proposal the ratepayers would in fact be paying 100% of the actually-incurred, reasonable remediation expenses; however, the ratepayers would be given time over which to pay these expenses, and the shareholders will bear the carrying costs associated with paying these expenditures over the amortization period. (Tr. at 223-225.)

"Staff identified other state commissions that had approved some sort of sharing of the costs of manufactured gas plant remediation as well as the following potential issues for the Commission: (1) whether, if certain Company actions increased the level of expenses that will ultimately be incurred, the increased costs should be excluded from the net recoveries at issue in this case; and (2) prospective remediation actions that currently cannot be evaluated for reasonableness (e.g., cost containment actions and indemnification from PRPs). (Exh. 22 (LeLash) at 59-62.)

precedent, Staff pointed to this Commission's previously approved ratemaking treatment of remediation costs for the Company that resulted in a sharing between ratepayers and stockholders through the amortization of costs over a certain number of years and the exclusion of the unamortized balance from rate base. (]d. at 62.) Staff also observed that in making a determination concerning the recovery of remediation costs, other commissions have given weight to whether or not the site at issue was being used to provide utility service and whether or not (as in this case) the site was owned by a third party, in which case remediation would provide no direct benefit to utility ratepayers. (]d. at 63.) Staff noted that in the non-regulated sector, remediation costs are generally not considered to be associated with current operations; instead, they are charged to retained earnings, which properly matches the expense with the underlying historical activity. (Id.)

51. With respect to incentives, Staff contended that the best and most logical incentive in this instance would be to place Chesapeake at risk for a portion of these costs. (]d.) According to Mr. LeLash, insurance reimbursement and assignment of liability to other PRPs were areas of cost containment that are within the Company's control, and by placing some of the risk on the Company the Commission can ensure that Chesapeake will take appropriate action, (id.) Moreover, witness LeLash asserted that stockholders are compensated in their cost of equity for risks associated with the Company's operations;
thus, it would be "illogical" to suggest that stockholders should not bear any of the risks associated with remediation costs. Had the Company's stockholders been granted risk-free returns, then, Mr. LeLash noted, there might be an argument that they should not bear any of the remediation costs. However, the Company's returns on equity have been such

that its stockholders have earned a premium for assuming certain risks such as those associated with remediation. Furthermore, Mr. LeLash observed, to the extent the Company and its predecessor did not follow procedures available to reduce the level of residual contamination from the manufacturing process, it was the stockholders who benefitted therefrom, (jd, at 64-65.)

52. Staff suggested that the Commission, generally, follow the procedure used in a settlement in Massachusetts to allocate the costs between stockholders and ratepayers on a 50-50 basis. Under the Staff proposal: (a) the actual expenses incurred by the Company will be amortized over seven years, with no rate base treatment for the unamortized balance; (b) the expenses incurred in each year will be placed in a pool for that year; (c) the annual amounts recoverable from each pool will be added together to reach the total annual amount to be recovered on an on-going basis from the ratepayers through a remediation rider; and (d) the remediation rider will be implemented as part of base rates and will be subject to change on an annual basis. (Tr. at 226.)

53. Staff further proposed that the remediation expense amortization be allocated to all throughput. (Exh. 22 (LeLash) at 70.) Staff explained that the use of a rider will have the following benefits: (a) it will reduce the need for regulatory proceedings associated with major expenses or reimbursements; (b) it will allow recovery of actual expenses only, subject to Commission review of their reasonableness prior to authorizing recovery; and (c) if timed to coincide with the Company's fuel clause filing, the review will obviate the need for additional regulatory proceedings. (Id. at 69.)

54. At the August 31,1995 evidentiary hearing, Mr. LeLash acknowledged the Company's concern that Staffs amortization proposal could result in the creation of a large regulatory asset *(i.e.,* the unamortized balance). He testified that if the Commission became convinced that the amount of such a regulatory asset was impairing the Company's financial stability, it could establish a cap on the amount of unamortized balance and allow the Company to earn the equivalent short-term interest rate on any amount in excess of that cap. (Tr. at 230-231.) However, Mr. LeLash emphasized that Staff was not recommending that any cap be established at this time because it did not believe that the unamortized expenses to date were significant enough to warrant such a provision. (Id. at 258-259, 266-267, 269.)

55. Staff asserted that Chesapeake's Smyrna claim should be denied. Staff contends that Chesapeake has failed to meet its burden of proving that the Chesapeake claim is appropriate because there is nothing in this record from which the Hearing Examiner can determine whether the property is used and useful in the provision of utility service, whether there is the potential for insurance reimbursement, whether there are any other potentially responsible parties, the remediation efforts undertaken, whether the Company still owns it, or even where it is; thus, there simply is no record support for the recovery of any costs associated with the Smyrna site. (Staff at 32; Staff-R at 15.)

56. **Discussion.** I have carefully considered the evidentiary record for this docket and the arguments of Staff and the parties and, for the reasons discussed below, I am persuaded that the Commission should allow Chesapeake to recover the environmental costs associated with the Dover site. With respect to the Smyrna site, Staff persuasively

26

argues that there is nothing in this record to indicate: (a) whether the property is used and useful in the provision of utility service; (b) whether there is the potential for insurance reimbursement for the remediation costs associated with the Smyrna site; (c) whether there are any other potentially responsible parties who might share the liability for the pollution of that site; (d) what, if any, remediation efforts the Company has undertaken with respect to the Smyrna site; (e) whether the Company still owns the Smyrna site; or, for that matter, (f) exactly where the site is located. Moreover, the record unequivocally demonstrates, and Chesapeake admits, that the Smyrna site has not been designated as a Superfund site by the EPA and is not presently the subject of any enforcement action. (CUC at 16.) Although the Company claims to have incurred consulting and legal fees of approximately $99,991 in connection that Smyrna site (Tr. at 169-171), I concur with Staff and the OPA that there is insufficient evidence in this record upon which the Commission can make an informed decision concerning this claim. Thus, I recommend that it be denied.[18] The ensuing discussion concerning recovery of remediation expenses, therefore, involves only those costs associated with the Dover MGP site.

57. My review of the evidentiary record indicates that, as a practical matter, the general lack of records covering the period when gas was manufactured at the Dover MGP site renders it impossible to determine the reasonableness of the past actions of the several PRPs who operated at the site during that time. Company witness Barefoot

^ is not also not clear from the record whether or not a portion of these alleged Smyrna-related costs are included in the stipulated revenue requirement If they are, then they should be removed from the stipulated revenue requirement at the time that the Commission issues its final Order concerning this Phase of this docket If the Smyrna-related costs are included in the

amounts to be amortized as recommended, *infra,* then they should, accordingly, be excluded from the final amount to be amortized.

27

confirmed this fact when he testified that he was not aware of internal Company records or reports discussing the specific operational standards for the Dover site. (Tr. at 125-126.) Furthermore, even if such records or reports were available, absent specific evidence of behavior on the part of the Company or its corporate predecessors that was inconsistent with then existing standards, it would be inappropriate to penalize Chesapeake for lacking the prescience to conform to today's rigorous environmental standards. Moreover, there have been numerous entities besides Chesapeake who may also have contributed to the pollution of the site. In addition, no party supports outright denial of any recovery of these remediation costs. Thus, the controversy in this docket centers around the resolution of the following issues: (a) the mechanism through which recovery will be effected; (b) the amount of remediation expenses to be recovered; and (c) the appropriate ratemaking treatment of these costs.

58. As noted above, Chesapeake seeks recovery of an aggregate amount of approximately $5.6 million in estimated remediation costs. The Commission has previously considered the issue of whether estimated clean-up costs for the Dover MGP site were recoverable through rates as well as the appropriate ratemaking treatment for such costs. In PSC Docket No. 85-17, the Commission declined to adopt Chesapeake's proposal to amortize $1.5 million of estimated costs that the Company anticipated it would incur to clean up the Dover MGP site because of "the uncertainty surrounding the nature and extent of any future expenditures on this matter."[19] The Commission, however,

[19] ^In the Matter of the Application of Chesapeake Utilities Corporation For A General Increase In Gas Rates Throughout Delaware And For Approval Of Other Changes To Its Tariff. PSC Docket No. 85-17, Order (continued...)

28

allowed a 5-year amortization of actually incurred clean-up costs amounting to $242,830. The Commission noted that its decision was "without prejudice to the Company's right to seek ratemaking treatment in the future for additional expenses relating to this matter should they be incurred."[20] Although the magnitude of estimated environmental expenses appears to have increased substantially, the uncertainty that concerned the Commission in 1986 has not, in this case, diminished to the extent that these costs should be included in the ratemaking calculus. The record of this docket convincingly demonstrates that the extent of future expenditures remains uncertain, and for the reasons previously stated in Docket No. 85-17, these estimated expenses should not be recovered through Chesapeake's rates. For example, Company witnesses have acknowledged that the environmental expenses are "estimates," and on brief, the Company concedes that although the issuance of the ROD may have made the extent of future expenditures less uncertain than they were at the time of Docket No. 85-17, the only thing certain at this point is the expectation that "Chesapeake will spend substantial sums of money in the near future." (CUC-R at 4, emphasis in original.) In addition, there is no evidentiary support in this record that the estimated $5.1 million is representative of the prospective expense that Chesapeake will have to incur for the remediation of the Dover MGP site. Indeed, if anything, the record suggests that Chesapeake's ultimate liability for remediation expenses could very well be below the currently estimated amount.

"(...continued) No. 2728 (Del. PSC^
March 25,1986), at page 6,1R2.

[20] Id.

29

59. The record indicates that after the EPA issued its ROD in August 1994, the State of Delaware, which was identified in the ROD as a PRP regarding the Dover site, reached a tentative settlement with the EPA. (Exh. 16 (McMasters-Supp.) at 1.) If realized, such a settlement could provide an additional source of funds for the remediation expenses and reduce the Company's estimated liability. In addition, in light of the State of Delaware's agreement not to build on the site, the Company and the State of Delaware are currently jointly negotiating with the EPA to reopen the ROD because the level of soil remediation contained in the ROD is not required. (Exh. 21 (Crane) at 18.) If this effort is successful, the Company's liability would also be reduced. In his rebuttal testimony, Mr. McMasters admitted that there are "several factors that are not known and/or measurable." (Exh. 17 (McMasters-R) at 13.) It would appear that some of these unknown factors could dramatically reduce the level of remediation expenses the Company will ultimately incur. Moreover, according to the OPA, Chesapeake recently filed a feasibility study with the EPA containing two alternative proposals for soil remediation containing estimated costs of $1.14 million or $1.55 million, respectively, each of which is well below the level of expense estimated in the ROD. (OPA at 14.) In addition, under cross-examination, Company witness Barefoot testified that he hopes that soil remediation costs will ultimately be reduced to "a million to a million-and-a-half dollars." (Id., citing Tr. at 98.)

60. There is a sound basis for excluding these speculative expenses from the ratemaking calculus. Delaware, like most other states, subscribes to the test year/test period ratemaking process, which equates a utility's revenue requirement with the total of:

operating expenses, depreciation, taxes, and a reasonable rate of return allowance on the

utility's rate base. Thus, when setting utility rates, this Commission has followed a practice of allowing utilities to adjust their test period rate base and/or expenses to include costs that will be incurred after the close of the test period when that adjustment reflects known and reasonably ascertainable changes to the utility's rate base and/or expenses. The underlying rationale for this practice is that ratemaking is prospective in nature and that the purpose of using a test period to establish rates is to provide a representative level of expense for recovery through rates on a going-forward basis. It is, therefore, essential that the expenses sought to be included in utility rates are recurring and can be determined with reasonable certainty and without speculation.

61. Chesapeake argues, however, that under Delaware law, the Commission is required to allow a utility to recover, through rates, all legitimate expenses incurred by the utility, and since its estimated environmental expenses are or will be "legitimate expenses," it is entitled to recover them through rates. (CUC at 35, citing Wilmington Suburban Water Corporation. Del. Supr., 211 A.2d 602 (1965).) I disagree. As I have discussed in previous rate proceedings,[21] such a claim is not an uncommon utility (and sometimes judicial) misapprehension of the regulatory process. The contention that utilities are entitled to recover all costs incurred except such costs as are found to have been due to management imprudence is contrary to well-established case law. See, *e.g.*. Re Southern California Gas Company. 109 PUR 4th 1, 31 (Cal. 1990), where the California Commission noted that:

[21] See. *e.g.*, Findings and Recommendations of the Hearing Examiner. PSC Docket No. 90-10, discussion at pages 31-35, which the Commission adopted by Order No. 3274, dated May 21,1991.

31

> *". . . [regulation] was never intended to relieve utilities of all of the risks inherent in competitive or regulated markets. Risk is inherent in doing business, even as a regulated utility. And more importantly, this n'sk is recognized in the rate setting process. Regulators are in fact required by law to set rates so as to provide utilities with a reasonable opportunity to earn a return commensurate with returns on investments with similar risks, (See, Federal Power Commission v. Hope Natural Gas Co.. 329 U.S. 591, 603, 51 PUR NS 193, 88 LEd 33, 64 S. Ct.281 [1944]). The law does not guarantee that utilities will earn the return authorized, however, (see Hope. supra, 320 U.S. at 603. 51 PUR NS 193), and certainly does not require utility ratepayers to shoulder 100% of the economic burden ofunforseen events. (Compare e.g., Duquesne Light Co. v. Barasch. 488 U.S.__, 98 PUR 4th 253, 102 LEd.2d 646, 109 S.Ct.609 (1989) upholding a rate base disallowance of costs associated with a canceled nuclear power plant without any finding of management imprudence.) On the contrary, the manner in which utility rates are set generally contemplates that unforseen events will, from time to time, affect company earnings and will sometimes cause earned return to fall below what was authorized. Utilities are routinely compensated for this very risk. The rates of return granted utilities in each general rate case include allowances to compensate utilities for economic and regulatory risks, including unforseen risks.* (Id.)

62. However, there are, on occasion, exceptional instances in which an abnormal expense arises in recognition of which a regulatory agency may depart from the normal ratemaking process and allow a form of rate recovery that is deemed just and reasonable under the circumstances for both the utility and its ratepayers. The Commission recognized such an exceptional case in its Docket No. 85-17 decision. In my view, although it did not specifically so state, in making its decision in Docket No. 85-17, the Commission also made a significant and clear distinction between the appropriate rate recovery of "operating expenses," which are, typically, recurring expenses necessary to the day-to-day operation of the utility, and the recovery of certain other types of expenses

which, generally, represent unique or extraordinary, non-recurring cost items.[22] In my opinion, the remediation expenses anticipated by the Company are "extraordinary" and would, therefore, qualify for such special treatment. First, it appears that, though unascertainable at this time, they may become significant over time, especially when compared to the Compan/s revenue requirement. Second, it is clear that these costs are non-recurring and, therefore, should not be reflected in rates established for prospective application. Third, as previously noted, although it is impossible to determine the reasonableness of the past actions of the several operators at the site over the years, it is clear that Chesapeake will be held responsible for a fairly significant portion of the clean-up costs.

63. Staff witness LeLash has proposed that because of the "extreme variability of expenditures and reimbursements," the Company's requested amortization should be limited to actual net expenses to avoid excessive under- or over-recoveries. (Exh. 22 (LeLash) at 52.) According to Staff, the Company's $5.1 million estimate represents the "worst case scenario" because, as previously discussed, the Company has failed to consider several factors which would mitigate a substantial portion of its claim. (Id. at 51.)

^This distinction is not unheard of in most other jurisdictions. For example, when confronted with a request from Potomac Edison Electric Company to amortize abnormal expenses, the Maryland Commission noted that normally, such a procedure is:

> **"... a departure from the test-year/cost-of-sen/ice methodology and is inconsistent with the prospective nature of rate making. Exceptions to this general principle are limited to clearly extraordinary losses or gains, and adjustments are made only to the extent that it is just and reasonable for the ratepayers to share in those losses or gains." Re Potomac Edison Company. 70 Md. PSC 403, 410 (Md. 1979).**

33

The OPA has also presented convincing testimony which is consistent with and supportive of the Staff position.

64. Essentially, Staff has recommended that the Commission adopt a procedure used in a settlement in Massachusetts. Under this procedure, the Commission would authorize the Company to amortize over 7 years the actual net remediation expenses incurred each year, with no rate base treatment for the unamortized balance. (Tr. at 226.) Staff witness LeLash explained that under the Staff proposal, the expenses incurred in each year would be placed in a pool for that year, and then the annual amounts recoverable from each pool would be added together to reach the total annual amount to be recovered from the ratepayers through a remediation rider that would be implemented as part of base rates and that would be subject to change on an annual basis. (Id.) Mr. LeLash also asserted that the use of a rider would have several benefits: (a) it would reduce the need for regulatory proceedings associated with major expenses or reimbursements; (b) it would allow recovery of actual expenses only, subject to Commission review of their reasonableness prior to authorizing recovery; and (c) the review could be timed to coincide with the Company's annual fuel clause, thus avoiding incremental regulatory proceedings. (Id. at 69.)

65. Given the fact that, as previously discussed, the traditional method of cost recovery would be inappropriate under the peculiar circumstances that exist in this proceeding, I find the procedure recommended by Staff and supported by the OPA to be a fair and reasonable compromise solution. I, therefore, recommend that the Commission adopt the Staff-proposed approach which would permit Chesapeake to recover over a 7-

year amortization period the actual net remediation expense which the Company incurs on an annual basis. I also recommend that these annual remediation expenses be subject to Commission review for their reasonableness and, thereafter, recovered through a rider mechanism to be considered in conjunction with the Commission's review of the Company's Fall fuel adjustment filing.[23] However, with respect to those remediation expenses which Chesapeake has incurred during the test period, I recommend that the Commission direct Staff and the Company to consult in order to ascertain the amount involved and after such consultations, to make recommendations to the Commission concerning the implementation as soon as practicable of a remediation rider.

66. Staff has proposed that the remediation rider be allocated to all throughput, which suggests that this allocation should be made on a per thousand cubic foot ("met) basis. I would not recommend such an allocation because it could adversely impact the rates of large consumers of Chesapeake's natural gas service, who may then be encouraged to switch to more competitive alternatives. In my view, the costs of the remediation rider should be assigned so as not to have an undue impact on any particular customer class. A reasonable approach that I would recommend is to spread the costs of the remediation rider equally among all service classifications so that each customer in each classification pays an equal share of the remediation expenses to be amortized.

[23] "Staff gave several convincing reasons for maintaining the remediation expense amortization separately from the fuel clause. First, the fuel clause accounting allows interest to be accrued on deferred balances, but under Staffs proposal, no such treatment would be given to unamortized remediation expenses. Second, the legal basis for the remediation rider differs from that for the fuel clause. Third, the fuel clause factor is not charged to all customer classes, whereas Staff recommended that the remediation expense amortization be allocated to all throughput. (Tr. at 70.)

35

67. Turning to the question of the amount of remediation expenses to be recovered, the record does not provide sufficient information to make a reasonable determination of the precise magnitude of these expenses. Although, as noted above, the Company asserts that $5.6 million is a "conservative" estimate of the remediation costs to be recovered, there is nothing in the record to support such an assertion. Indeed, if anything, the record tends to confirm that the Chesapeake estimate may well be, as witness LeLash pointed out, a "worst case scenario." (Exh. 22 (LeLash) at 51.) Mr. LeLash presented convincing testimony that: (a) the State of Delaware appears close to settling the EPA's claim against it, which would reduce the amount of remediation costs that the Company would have to pay; (b) a modification to the ROD, which Chesapeake is seeking, could reduce the soil remediation costs by more than $2 million; (c) the Company did not include in its estimate any allowance for outstanding claims against other PRPs, despite substantial expenditures incurred in pursuit of such claims; and (d) even if the ROD were not modified, the expenditures necessary to meet the ROD requirements will extend over a longer time period than that assumed by the Company. (Id. at 51-52.) In view of the foregoing, Mr. LeLash contended, it is likely that the Company's estimate is overstated and that collecting the full amount of Chesapeake's estimate through rates would probably result in an overcollection. (Id. at 52.) Chesapeake appears to acknowledge the potential for overcollections by recommending that the Commission allow recovery of its estimated costs but provide for a procedure that would implement a refund to ratepayers for overcollections. Thus, it is difficult, if not impossible, to determine even a reasonable "ball park" figure. In view of the foregoing, I recommend that the Commission

find that the record does not provide sufficient information to enable it to make a reasonable determination of the precise magnitude of remediation expenses for which Chesapeake will be responsible.

68. This difficulty of making a precise calculation of the amount of remediation expenses Chesapeake will have to bear is, in my opinion, further support for the reasonableness of the Staff proposal which would allow the Company to make a dollar-for-dollar recovery through a rider mechanism of actual expenditures for the clean-up of the Dover site. Nonetheless, the Commission should address Chesapeake's concern that at some point in the future, the recommended amortization procedure could produce a large unamortized balance, which would create a large regulatory asset. Thus, I would recommend that the Commission adopt as reasonable Mr. LeLash's suggestion that if, at some future time, Chesapeake convinced the Commission that such a regulatory asset was impairing the Company's financial stability, then the Commission could establish a cap on the magnitude of the unamortized balance and allow the Company to earn the equivalent short-term interest rate on any amount exceeding the cap. (Tr. at 230-231.)

69. Turning to Chesapeake's request that the Commission authorize rate base treatment of the unamortized balances of its estimated remediation expenses, there are several reasons why the Commission should deny the Company's request. First, regulated utilities, such as Chesapeake, have traditionally been allowed to earn a return only on plant which was used and useful in the provision of public utility service. The underlying rationale for this ratemaking principle is that "[t]he used and useful standard ... ensures that the ratepayers will not be required to pay for that which provides no

37

discernible benefit." Re Williston Basin Interstate Pipeline Company. 105 PUR 4th 374, 385 (F.E.R.C. 1989). As a fundamental general proposition, under Delaware law, a utility may earn a return only on investment that is "used and useful" in providing utility service. 26 Dei. C, §102(3)a. It is indisputable in this case that the Dover MGP site is not and never will be used and useful in providing utility service to Chesapeake ratepayers. In fact, the Company sold the site to the State of Delaware in 1949 (Exh. 22 (LeLash) at Schedule 14), prior to the enactment of the Public Utility Act, which commenced the regulation of utilities in Delaware. Moreover, Chesapeake witness Barefoot admitted that the Dover Gas Light Site is not now, nor will it ever be, used and useful in providing utility service to Chesapeake customers. (Tr. at 136.)

70. I am also not persuaded by Chesapeake's contention that its estimated remediation expenses should be given rate base treatment because these expenses qualify, pursuant to 26 Del. C, §102(3)g, as an "element of property .. . necessary to the effective operation of the utility." In PSC Docket No. 91-20[24], the Commission addressed a similar contention by Delmarva Power and Light Company that the Commission had the discretion under §102(3)g to include items in rate base even if they did not satisfy the "used and useful" requirement and, thus, could include in rate base the remaining unrecovered investment in a prematurely-retired cooling tower. Despite Delmarva's assertion that removing the cooling tower from rate base would require it to incur a writeoff, the Commission allowed a 10-year amortization of the remaining investment, without

(Del. PSC, March 31,1992).

38

rate base treatment. The Commission articulated its reason for declining Delmarva's request for rate base treatment as follows:

> "Under 26 Del. *Q.*. §102(3)a, as a general principle, utility property or investment must be "used and useful" to be included in rate base. Here, the evidence is undisputed that the retired cooling tower is no longer providing service to Deimarva's ratepayers...." PSC Docket No. 91-20, Order No. 3389 at 25.

In this case, the evidence is undisputed that the Dover site never was and never will be used to provide utility service to Delaware ratepayers, therefore, no expenses associated with it should be included in rate base. The Commission should, therefore, deny rate base treatment of the remediation expenses.

71. Nor should the Commission be swayed by the Company's contention that it is unreasonable to expect its equity investors to bear any portion of these remediation costs. As noted, *supra* at ^60, utility shareholders, including Chesapeake's, are routinely compensated through the rate of return on equity for unforeseen risks such as the remediation costs. It is appropriate and reasonable, therefore, that the Company's shareholders bear some of the burden of this abnormal expense by foregoing the collection of the carrying costs associated with the amortization. Furthermore, as Staff points out in its Answering Brief, if the amortization proposal recommended herein is adopted, the Company will suffer no actual book loss if it is denied carrying costs on the unamortized balance. (Staff-R at 5.) As long as Chesapeake is provided rate recovery of its remediation expenses, the absence of carrying costs on any unamortized balance will not result in any charge to operating income. (Id.)

72. Turning to another issue raised by the Company in this docket, in January, 1993, pursuant to the authority granted under 26 Del. C. §310, the Commission established PSC Docket No. 93-20 and directed its Staff to investigate Chesapeake's achieved rate of return for the 12 months ending June 30, 1992 to determine whether or not the Company's current rates produced earnings which exceeded the level required to yield Chesapeake's authorized overall rate of return of 11.47% and 12.75% return on equity. The Staff investigation determined that Chesapeake was earning in excess of its authorized rate of return, and in order to avoid a formal proceeding to reduce its rates, Chesapeake proposed to do so voluntary, provided the Commission would allow the revised rates to include a 7-year amortization for the unrecovered balance of $749,971 of certain environmental expenses. (See, February 23, 1993 Memorandum of William C. Schaffer to the Commissioners at 2.) Staff and the OPA supported the Chesapeake proposal (Jd. at 2-3), which the Commission adopted on February 23, 1993 by Order No. 3570. The Commission's order revised Chesapeake's then effective rates to reflect a $125,000 reduction in the Company's annual revenue requirement and a recovery of a 7-year amortization of environmental expenses. It does not appear at the time that Chesapeake raised the issue of rate base treatment for these expenses. As previously noted, Chesapeake now seeks to have the amortization continue but with the unamortized balance of approximately $491,052 placed in rate base.

73. Both the OPA and Staff assert that the Commission should reject Chesapeake's request to include the so-called Docket No. 93-20 costs in the Company's rate base. I concur with these assertions for the reasons already discussed above at

length. Moreover, it is well established in Delaware that utility rates are set for prospective application and that rates cannot, therefore, seek to recover costs associated with past expenses. (See, Public Service Commission v. Diamond State Telephone Co., Del Supr., 468 A.2d 1285,1298 (1983), *where the Supreme Court denied a utility's request to recover in present rates past costs that the Court found the Commission had erroneously excluded from rate base. Thus, even though the Court reversed the Commission's decision on appeal, it precluded the utility from imposing a surcharge to recover from current customers the losses it incurred in providing service in the past.)* Giving rate base treatment to costs determined and approved in a previous docket would, in my view, violate this fundamental ratemaking principle and would, therefore, be inappropriate. It makes no difference, as Chesapeake contends, whether or not the costs in question are legitimately incurred in the normal course of business. Once they were incurred outside of the test year/test period, they may not be recovered through rates established for prospective application absent specific legislative authority. In view of the foregoing, it would be inappropriate to place the costs associated with Docket No. 93-20 in the Company's rate base as determined in this docket. I, therefore, recommend that the Commission deny the Chesapeake request.

74. Chesapeake also contends that these remediation expenses be afforded rate base treatment because they are comparable to an allowance for cash working capital. (CUC-R at 6.) According to the Company, the inclusion of working capital in rate base "recognizes that the investors must be compensated for the use of their funds." (Id.) The Company argues that working capital, like the unamortized environmental costs, represents capital requirements necessary to fund the Company's payment of operating

41

expenses pending recovery of the expenses from the rate payer. (Id.) In my opinion, the Company has misconstrued the rationale for the placement of working capital in rate base. A recent decision from the Federal Energy Regulatory Commission (FERC) articulates this rationale as follows:

> "... it is well-established that ratepayers should not bear the costs of items from which they do not benefit. This requirement also applies to working capital. Working capital includes the purchase of any asset that is used and useful to the pipeline's customers, but for which there is a lag in the pipeline's recoupment of the cost of the asset. Hence, the Commission has traditionally permitted the cost of such assets to be reflected in rate base in order to reflect the carrying cost of the asset. Such assets include non-facilities items, such as prepaid insurance and, of relevance to Williston's argument, storage working gas. Regardless of the nature of the working capital asset, it must be used and useful to the pipeline's customers." Re Williston Basin Pipeline Co., 111 PUR 4th 484, 487 (FERC, 1993).

I am, therefore, not persuaded by the Company's argument and recommend that the Commission disallow rate base treatment of the remediation expenses under the theory that these expenses should be afforded the same treatment as cash working capital.

75. Lastly, in support of its contention that the Commission should allow rate base treatment for the environmental expenses, the Company cites decisions from several other jurisdictions which, it claims, support the proposition that allowing such ratemaking treatment is appropriate. I have reviewed these cases and am not convinced by Chesapeake's arguments since it appears that all of cases cited are distinguishable from this case because the utility either owned all or most of the sites being investigated, or the sites were found to be "used and useful," or the treatment granted was exceptional in that

42

rate base treatment was being allowed only for the specific case under consideration because of certain distinguishing factors.[25] (See, *e.g.,* Staff-R at 5-6,13-14; see a/so Be: Public Service Electric and Gas Company. N.J. Board of Regulatory Commissioners, BRC Docket No. ER91111698J (September 15, 1993) at 15-16.)

76. In sum, my recommendation is that the Commission deny rate base treatment for any of the Company's remediation expenses because the record clearly demonstrates that these expenses fail to meet the "used and useful" test.

IV. RECOMMENDATIONS

77. In summary, and for the reasons discussed herein, I propose and recommend the following to the Commission:

A) That the Commission approve the Stipulation and Agreement discussed and described herein, and which is entered into the evidentiary record of this proceeding as Exhibit 19;

B) That the Commission deny recovery of any and all costs associated with the so-called Smyrna site;

C) That the Commission permit a *7-year* amortization of Chesapeake's actually incurred annual net remediation

^Indeed, in the Iowa Southern case, which Chesapeake cited at length, the Iowa Commission permitted the utility to include in its revenue requirement a representative amount comprised of the average of actual 1989 costs and estimated 1990 and 1991 costs. (Re Iowa Southern Utilities Company at 24-25. Docket No. RPU-89-7 (Iowa, Sept. 14,1990); emphasis added.) However, in this case, Chesapeake seeks to include in its revenue requirement the entire amount of its estimated costs, which may be incurred over a number of years extending far into the future. Furthermore, unlike the situation in this case, in Iowa Southern, the process of investigating and determining whether remedial action was required had only recently begun.

expenses associated with the Dover site, subject to Commission review for their reasonableness;

D) That such amortization be implemented by means of a rider mechanism to be considered in conjunction with the Commission's review of the Company's Fall fuel adjustment filing;

E) That the Commission direct Staff and the Company to consult in order to review Chesapeake's actually incurred test period remediation expenses and to implement a rider to begin the amortization of these costs as soon as practicable;

F) That the Commission adopt as reasonable the Staff recommendation that if, at some future time, Chesapeake convinces the Commission that the amortization plan established in this docket creates a regulatory asset which threatens to impair the Company's financial stability, then the Commission will consider appropriate action to remedy the then existing situation;

G) That the Commission spread the costs of the remediation rider equally among all service classifications;

H) That the Commission find that the record is insufficient for determining the specific amount of remediation expenses for which Chesapeake will be responsible; and

1) That the Commission deny rate base treatment of Chesapeake's remediation expenses, including the unamortized balance of the expenses identified for amortization in PSC Docket No. 93-20.

Respectfully submitted,

/s/ G. Arthur Padmore

G. Arthur Padmore
Hearing Examiner

Dated: November 1,1995

E X H I B I T "A"

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF CHESAPEAKE UTILITIES CORPORATION FOR A GENERAL INCREASE IN GAS RATES THROUGHOUT DELAWARE AND FOR APPROVAL OF OTHER CHANGES TO ITS TARIFF (FILED APRIL 4, 1995)	*	PSC Docket No. 95-73

STIPULATION AND AGREEMENT

Chesapeake Utilities Corporation ("Chesapeake" or "the Company"), the Staff of the Delaware Public Service Commission ("Staff"), and the Office of the Public Advocate ("OPA") hereby submit to the Delaware Public Service Commission ("Commission") this Stipulation and Agreement ("the Stipulation") as a resolution of all issues which were raised in this proceeding except the issues relating to the appropriate rate making treatment of environmental expenses and rate design. The parties believe that Commission approval of the Stipulation is in the public interest.

I- PROCEDURAL HISTORY

1. On April 4, 1995, Chesapeake filed an application for an increase in its gas base rates, which was docketed as PSC Docket No. 95-73. Chesapeake's application sought an approximate $2,751,189 rate increase in total base rate revenue based on the test period ending September 30, 1995 and an overall rate of return of 10.91 percent based upon a return on equity of 12.15 percent. Of this amount, approximately $1,023,000 represented the revenue

requirements associated with environmental expenses. According to the Company, the reasons for the requested increase in base rates in part were: (1) to reflect increased investment resulting from the Company's investment in plant; (2) to reflect certain costs associated with the implementation of Chesapeake's new customer information system; (3) to reflect higher operating and maintenance costs; (4) to recover actual and forecasted environmental costs and to earn a fair return on its investment.

2. On the 26th day of April, 1995, by Order No. 3988, the Commission suspended the proposed rate increase. On May **23,** 1995, by Order No. 4011, the Commission authorized the Company to place into effect under bond, and subject to refund, $1,000,000 of its proposed rate request as of June 3, 1995.

3. On or about July 26, 1995, Staff and the OPA filed affirmative testimony on the appropriate revenue requirement for the Company. Staff filed testimony recommending a return on equity of 11 percent for the Company and OPA concurred with Staff's recommendation. The total adjustments recommended by OPA and Staff resulted in revenue requirement increase recommendations of $593,888 (OPA) and $328,000 (Staff).

4. On or about August 10, 1995, Chesapeake filed affirmative rebuttal testimony pursuant to which it reduced its proposed revenue requirement increase to $2,390,582, of which approximately $980,000 related to the recovery of environmental costs. Moreover, in its rebuttal testimony, the Company requested an overall rate of return of 10.27 percent based upon a return on equity of 11.75

II. STIPULATION

As a result of several meetings and negotiations, the parties have agreed as follows:

1. The parties recommend for the Hearing Examiner's and Commission's approval a base rate revenue increase of $900,000 for the Company, with the revised, rates becoming effective for usage rendered on and after December 1, 1995. This proposed increase in base rates resolves all revenue issues between the parties, with the exception of the appropriate revenue requirement and rate making treatment for environmental expenses. Implicit in this recommendation is a return on common equity of 11.5 percent and the following overall cost of capital:

	Percent	Cost Rate	Weighted Cost
Long Term Debt	43.14%	8.31%	3.58%
Common Equity	56.86%	11.5%	6.54%
Total	100.00%		10.12%

Except as identified herein, no other issues have been specifically included or excluded in reaching the overall revenue increase submitted for the Hearing Examiner's and Commission's consideration.

2. In addition to the use of common equity of 11.5 percent, the parties have agreed that the following revenue requirement issues shall be encompassed in the overall Stipulation:

a. In its next base rate proceeding, the Company will use a weather normalization methodology relying upon weather data for the most recent consecutive 30-year period. The use of said 30-year period shall not, however, be binding upon Staff or the Commission.

b. The Company's rates will reflect the inclusion in rate base of

$1,200,000 relating to the reasonable costs associated with the installation of the Company's new customer information system. Specifically, the rates reflect a 15 year annual amortization in the amount of .$80,000.

c. The parties agree that the Company's existing rates include the amortization of environmental costs as approved by the Commission in Docket No. 93-20 in an annual amount of $107,138.

3. The Company's depreciation rates, as approved in the Company's prior base rate proceedings, will remain in effect except that effective December 1, 1995, the Company will implement a depreciation rate of 2.85 percent for Account Number 311 -Liquified Petroleum Gas Equipment.

4. One issue in this docket is related to the allocation of overhead costs capitalized to General Plant. The Company agrees to affirmatively address this issue in its next base rate proceeding.

III- GENERAL PROVISIONS

1. This Stipulation represents a compromise for the purposes of settlement and shall not be regarded as a precedent with respect to any rate making or any other principle in any future case. No party to this Stipulation necessarily agrees or disagrees with the treatment of any particular issue in agreeing to this Stipulation other than as specified herein, except that the parties agree that a just and reasonable resolution of the revenue requirement issues addressed herein.

2. The various provisions of the Stipulation **are** not severable. None of the provisions shall become operative unless and until the Commission issues an Order approving the Stipulation as to all of the terms and conditions without modifications or conditions, other than as specified herein. The provisions shall be subject to waiver only by the unanimous agreement of the parties. If

any portion of this Stipulation is modified, conditioned, or rejected, it shall be considered null and void and each party individually reserves the right to proceed with a full base rate investigation as contemplated in the Commission's Order in this proceeding.

IV. CONCLUSION

The parties respectfully request the Hearing Examiner and the Commission to favorably consider the terms and conditions set forth in the Stipulation and Agreement as an appropriate resolution of the various issues raised in this proceeding. As heretofore noted, this Stipulation and Agreement does not resolve the issue of the appropriate revenue requirement and rate making treatment of environmental expenses, nor does it address issues involving rate design.

Respectfully submitted,

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